



**Asia-Pacific  
Economic Cooperation**

# **APEC Economic Policy Report 2010**

**APEC Economic Committee**

**Advancing Free Trade for Asia-Pacific Prosperity**

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# Contents

<b>1. Corporate Governance and Sustainable Economic Growth</b>	<b>1</b>
Why Corporate Governance Is Important to APEC Economies	2
Historical Insights	2
Companies and Corporate Governance Today	5
Recent International Reforms	9
Corporate Governance and Sustainable Economic Growth	15
<b>2. Legal and Institutional Foundations of Corporate Governance in APEC Economies</b>	<b>19</b>
Introduction	19
Purpose	19
Common Elements for Corporate Governance in APEC Economies	21
Enforcement Institutions and Processes	28
Areas for Further Reform in Corporate Governance Law and Regulation	34
<b>3. Individual Economy Reports Summary</b>	<b>39</b>
Institutional Features of Corporate Governance and Company Profiles	39
Corporate Governance Rules: Development, Enforcement, and Practice Assessment	41
Awareness and Advocacy	42
Corporate Governance of State-Owned and Family-Controlled Enterprises	43
Professional Service Providers and Corporate Governance	44
Recent Developments	45

## Annex: Individual Economy Reports on Corporate Governance

• Australia	51
• Canada	59
• Chile	71
• Hong Kong, China	81
• Indonesia	101
• Japan	113
• Republic of Korea	121
• Malaysia	129
• Mexico	151
• New Zealand	161
• Peru	169
• Philippines	175
• Russian Federation	185
• Singapore	199
• Chinese Taipei	207
• Thailand	215
• United States	225
• Viet Nam	237

## Illustrations

### Figures

Figure 1-1. Corporate Governance Models	10
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### Tables

Table 1-1. Excerpts from Studies of Corporate Governance and Company Performance	15
Table 2-1. Level of Interest in Ways of Strengthening the Economic and Legal Infrastructure in APEC	20
Table 3-1. Most Common Priorities for Reform	46
Table 3-2. Summary of Key Corporate Governance Rules and Practices in APEC	47

### Exhibits

Exhibit 1-1. Art Reflects Business Life	4
Exhibit 1-2. Corporate Governance and the Agency Problem	5

# Preface

The recent global financial crisis has, among other things, served to reinforce the importance of effective corporate governance, and the contribution that it can make to sustainable economic growth. The 2010 edition of the *APEC Economic Policy Report (AEPR)*, which focuses on corporate governance in APEC, is therefore a timely one, particularly given the current emphasis on examining how future crises can be avoided – including through implementing structural reforms.

Corporate governance is by no means a new issue on APEC's structural reform agenda, and is one of the five priority areas within the Leaders' Agenda to Implement Structural Reform (LAISR). Various workshops, seminars and other activities on this theme have been held under the direction of the APEC Economic Committee. It is also a topic of interest for other APEC groups, including the APEC Finance Ministers' Process and the APEC Business Advisory Council. APEC has—and continues to—cooperate closely with the OECD on corporate governance issues, given the OECD's extensive work in this area.

In line with the format of previous years' AEPRs, the 2010 publication contains three chapters. The first chapter provides a historical context for corporate governance, explains why the concept is important for APEC, and draws linkages between corporate governance and economic growth. The second chapter describes the ways in which corporate governance issues are addressed by APEC economies, whether through their legal systems, enforcement institutions or future reform efforts. Unsurprisingly, there are both common features and variations in the corporate governance systems that are currently in use in APEC. The third chapter reviews individual economies' experiences of, and approaches towards, corporate governance.

I will encourage APEC policy makers, as well as corporate enterprises and academia, to use this valuable resource in order to better understand the various corporate governance structures that exist in APEC. The 2010 AEPR does not seek to favour any particular approach to corporate governance, since there is no “one size fits all” system that can be applied to all contexts. Rather, it hopes to promote further thinking on corporate governance through information and experience sharing.

The AEPR is made possible through the collaborative effort of all member economies, the APEC Secretariat and the Economic Committee Chair's Office. I would like to extend a special thanks to the United States for contributing the first and third chapters, Japan for drafting the second chapter, and member economies for submitting individual reports on their experience on corporate governance.



Takashi Omori

Chair, APEC Economic Committee

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# 1. Corporate Governance and Sustainable Economic Growth

Corporate governance has been on the agendas of APEC member economies for years. It is part of the structural reform agenda of the Economic Committee and the Finance Ministers' agenda covering the "deepening and strengthening of the region's financial systems," and is a perennial topic at meetings of the APEC Business Advisory Council. The joint statement issued for the 2008 APEC Ministerial Meeting read:

We welcomed the Economic Committee's efforts to intensify the ongoing work under the five priority areas of the Leaders' Agenda to Implement Structural Reform (LAISR). LAISR addresses issues related to the responsibility of governments for the transparent development and implementation of legislation in order to effectively regulate business in the interests of the citizens. We noted the Committee's work to promote good corporate governance, including by affirming the "OECD Principles of Corporate Governance" and working on a plan to ensure APEC's continued implementation of the Principles in the Asia-Pacific context.

Corporate governance became prominent on the APEC agenda in step with globalization, especially as globalization spread from international trade to capital markets. It became even more prominent in the wake of the Asian Financial Crisis of 1997, and was included as one of five priority items in the Leaders' Agenda to Implement Structural Reform (LAISR) featured in the 2006 APEC Economic Policy Report.<sup>1</sup> When APEC Ministers met in Lima in August 2008, and the EC hosted a workshop on corporate governance, tremors from a new financial crisis were being felt.

The most recent crisis has generated a new round of professional and public interest in enhancing the efficacy of corporate governance and the performance of boards, particularly at financial institutions. Analysts are examining causes of the crisis, and policymakers are exploring, proposing and implementing reforms to correct deficiencies and reduce the risk of repeated crises.

In the rest of this chapter, we revisit the main reason why APEC economies have placed corporate governance on the common agenda—because of its contribution to sustainable economic growth. We review historical insights into the relationship between corporate governance and growth, the formal analysis supporting that relationship, salient issues and recommendations related to perceived weaknesses in governance, and practices recently

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## **What is Governance?**

Governance is the set of rules adopted and followed by people with a shared interest in an institution or enterprise for the purpose of directing and managing that institution or enterprise.

## **What is Corporate Governance?**

Corporate governance is governance applied to private companies, primarily those with many shareholders and publically traded shares.

## **As Defined in OECD Principles**

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. It provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

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<sup>1</sup> Between 2000 and 2003, a series of corporate collapses in the US and Europe—Enron, Tyco, Global Crossing, Royal Ahold and Parmalat—prompted far-reaching reforms to strengthen financial accounting, financial reporting and corporate governance.

adopted in some economies to improve standards and strengthen corporate governance in ways that enhance corporate performance and sustainable economic growth.<sup>2</sup>

In Chapter 2 we explore the legal structure of corporate governance in APEC economies, presenting some common features and variations in the systems currently in use. In Chapter 3 we present Individual Economy Reports (IERs) and describe selected activities underway in many economies to strengthen corporate governance in ways that respond to shareholders' concerns and enhance the ability of companies to contribute to sustainable economic growth.

## WHY CORPORATE GOVERNANCE IS IMPORTANT TO APEC ECONOMIES

The August 2008 APEC Workshop on Corporate Governance included presentations from Australia, Chile, Singapore and Chinese Taipei, all making a convincing case for the value of corporate governance to APEC economies, individually and collectively. Key points were as follows:

- Good corporate governance is important to companies and shareholders as an integral part of a company's value creation activities.
- Confidence in corporate governance is essential in attracting individual and collective or contractual savings into securities issued by companies.
- Good corporate governance is critical to financial deepening and the smooth functioning of the financial system in any economy and to operations of capital markets in economies that have them.
- A reputation for reliable governance is a prerequisite for attracting foreign investment.
- In many economies, corporate governance is raising awareness about the importance of enterprise, productivity, and competitiveness and the challenges and risks inherent in trying to achieve a higher standard of living over time.

In the wake of the global financial crisis, we can add to this case: corporate governance must be improved to help rebuild investors' confidence, to restore liquidity and health to financial markets and enterprises, and to reduce the frequency and severity of financial crises.

## HISTORICAL INSIGHTS

### Roots and Evolution of Business “Companies”

In the early 17<sup>th</sup> century, businessmen in Great Britain and the Netherlands were the first to form “joint stock companies”. These precursors of today's corporations were formed to undertake a variety of difficult, risky and expensive ventures—including exploration and development of largely unknown lands in North America and trade routes to the East.<sup>3</sup>

The company structure quickly proved itself a useful way to organize a business venture and attract investment funds. Groups of businessmen without titles or royal lineage, unrelated to each other by blood or marriage began using a company-type arrangement to organize, manage

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<sup>2</sup> This report focuses on corporate governance as it applies to private companies listed on the leading stock exchange in an economy and therefore subject to rules imposed by that exchange; however, many of the principles apply in whole or in part to other types of corporations including not-for-profit, state-owned and large family-owned corporations.

<sup>3</sup> The British East India Company was chartered by Queen Elizabeth I in 1600. The Dutch East Indies Company was granted a royal charter in 1602. *Corporate Governance*, 4<sup>th</sup> Edition, p. 97.

and govern larger and increasingly more complex undertakings. Under this new form of organization investors and directors agreed to trust each other and be bound by rules and procedures for making decisions about sharing costs, risks, and rewards and for choosing and supervising managers. These agreements, rules and processes were the foundation and precursors of modern corporate governance.

## Added Advantages of Incorporation

Over time the company<sup>4</sup> model for business organization managed to achieve special recognition and status under law.<sup>5</sup> Today most economies have a “Company Law” that spells out the basic requirements and special attributes that the law affords to businesses that elect to organize as incorporated companies. The special attributes include:

- Legal personage
- Perpetual life (determined by owners/shareholders)
- Limited liability of owners
- Divisibility of ownership.

Together these features make it easier and somewhat safer for people to pool resources in larger ventures. Legal personage endowed a company with other basic powers—the right to enter into contracts, own property, issue obligations, sue and be a party to legal proceedings.

Legal personage also meant the corporation’s existence and activity did not necessarily have to end with the death of any one individual or generation. Investors were responsible (liable) for debts incurred or damages caused by the corporation only up to the limit of their investment. The divisibility of ownership facilitated transferability of ownership interests without disrupting the structure of the organization. Any shareholder could sell his or her shares to any other party. This, in turn, facilitated the buying and selling of shares in the secondary market, which made this type of investment more acceptable for smaller investors who may avoid investments that cannot be turned into cash in an emergency.

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<sup>4</sup> In this report, “company” denotes a business organization whose ownership structure is based on shares held by shareholders, with a legal personality and limited liability for shareholders. This term is commonly used in APEC economies to refer to business ventures that have incorporated under the prevailing “company” law. Other terms are “society”, “corporation” and “sociedad anonima”.

<sup>5</sup> Students of business and law in the US are required to read the Supreme Court’s decision in the 1819 case of *Dartmouth College v. Woodward*, written by Chief Justice John Marshal legally recognizing the basic features of corporations.

## Exhibit 1-1

*Art Reflects Business Life*

Portraits of guild masters and businessmen in 17<sup>th</sup> century Netherlands, by Rembrandt and other artists, represented a revolution in art based simply on their subject matter. Until that time most art dealt with religious figures or classical myths and legends. Portrait art was reserved for the nobility or church hierarchy. These businessmen were showing an increased willingness and capacity to pool their talents and fortunes together into joint enterprises. And some of these groups had become successful and important enough to commission group portraits of themselves – reflecting in art the new trend in commerce. The subjects in this painting by Rembrandt are the members of cloth dyeing guild in the Netherlands. (Source: *The Ascent of Man* by Jacob Bronowski)

These features have enabled companies built on shareholdings to grow and spread to many economies. But they have not insulated them or shareholders from a problem intrinsic to all arrangements in which one person turns responsibility for something he values (e.g., hard-earned savings) over to another. Within 20 years of their creation, shareholders in some of the joint stock companies in the Netherlands resorted to pamphleteering and public protest to complain about their treatment and rights.<sup>6</sup> And within 100 years shareholders saw the value of their shares and savings shrink drastically with the collapse of the South Sea Company (1720) and other “bubble” corporations. This gave rise to serious questions about the way shareholder companies were governed and managed and what rights or protections shareholders could expect.

### **Intrinsic Problem of Corporations**

The “pooled investment” structure of the corporation embodies a particular problem that arises any time a person is given power over resources (investments) that belong to another. Managers or directors of a company vested with control over resources that do *not* belong to them cannot

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<sup>6</sup> Smaller investors in the Dutch East Indies Company were called “participants”, with rights to a share of profits, but no other rights of ownership or control. This led to one of the earliest episodes of shareholder activism in the Netherlands in 1622, when “participants” published pamphlets seeking to have a greater voice in governance and citing the example of rights that shareholders in England enjoyed. [*Shareholder Activism at the Dutch East India Company in 1622*, J Matthis de Jongh, October 28, 2009.]

always be expected to manage those resources with the same care and attention that they would in managing their own resources. Some business texts call this the dilemma of managing “other people’s money” or OPM; economists call it the “agency” problem.

The agency problem was less of a concern for some early 17<sup>th</sup> century small companies whose few shareholders lived in the same town or district. As a rule, the directors and the major shareholders were one and the same, and the directors knew both their business and their fellow directors very well. The shareholders would elect one among them to preside over the meetings from a special chair (Chairman). This helped put practical limits on the agency problem. However, such conveniences and limits diminished as corporations grew larger and began to raise capital from larger numbers of smaller investors with neither the time nor the capacity to participate in the governance of the company.

Convening meetings of numerous, widely dispersed shareholders became more expensive and less practical. Out of necessity corporations adopted more formal rules of representative governance but still based on the principle of one share=one vote. On that basis, only the largest shareholders could be directors, and they were “expected” to act on behalf of all shareholders not just in their own personal interest. This practical but partial response to the agency problem has been followed by many others even as an enduring or comprehensive solution remains elusive. Some scholars suggest that the search for such solutions is unrealistic and that corporate governance should be seen as the best way to address the inescapable agency problem. See Exhibit 1-2.

Exhibit 1-2

*Corporate Governance and the Agency Problem*

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Corporate governance is our mechanism for addressing the core conundrum of capitalism, the agency problem. Corporate governance is a way of addressing and answering the questions:

- How do we make a manager as committed to the creation of long-term shareholder value as he/she would be if he/she were managing his his/her own money?
- How do we manage corporate value creation in a manner that minimizes the externalization of costs onto society at large?

Good corporate governance requires a complex system of checks and balances to work well. In the last decade (1990-2000) we saw a perfect storm of failures, negligence and corruption in every single category of principal and gatekeeper: managers, directors, shareholders, securities analysts, lawyers, accountants, compensation consultants, journalists and politicians. But the primary focus [should be] on the three key actors in the checks and balances of corporate governance: management, directors and shareholders.

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SOURCE: Monks, Robert A.G. and Nell Minow, *Corporate Governance*, 4<sup>th</sup> Edition, John Wiley & Sons, Ltd., 2008, p. 3-4.

## **COMPANIES AND CORPORATE GOVERNANCE TODAY**

The company as a form of business organization has spread around the world. Most economies have adopted some form of a “company law”. The company form would not be so widespread if companies had not created value and contributed to the growth of economies governed by laws that have allowed them to flourish. Still, it is a mistake to think that companies inherently generate value, wealth and economic growth. Companies can also misdirect, diminish, and destroy value and hinder economic growth—especially if they deviate significantly from the principles of sound corporate governance.

## Performance, Governance and Growth

The contribution of any company to the growth of an economy depends on the company's ability to create something of economic value to buyers in local or export markets. Unfortunately, there is no guarantee that a company, however well intentioned, inspired, or equipped, will create products or services that buyers will always consider the best value. Even full adherence to the best practices of corporate governance cannot provide such a guarantee. Under market rules, buyers are the ultimate judges about how "valuable" a company's products and services are, and the collective purchasing decisions of buyers determine which companies succeed and grow.

Indeed, the historical record of company performance and economic growth is not one of unbroken progress, but a complex tale of winners and losers rich with examples and episodes of failure and collapse as well as success. When the winners—those who create better value—are encouraged and allowed to prevail, the tale also describes a trend that favors economic growth.

Most company failures are part of the normal process of trial and error, risk, and market discipline with which every company must cope in competing for a buyer's attention and purchases. The failure of a single company—while losing value for a company's shareholders and creditors—does not necessarily diminish contributions to economic growth. In fact, the survival and growth of better companies strengthen and accelerate general economic growth.

Good corporate governance, therefore, should not be seen as a guarantee against the underperformance or failure of an individual company, but as a mechanism for bolstering how company success contributes to economic growth.<sup>7</sup> The standards of good governance do this by requiring companies to provide accurate and timely information about performance and status to key participants and decisions makers (e.g., buyers, investors, lenders, governments), as well as boards of directors.

When companies conform to high standards of governance, information about performance is readily available, and buyers and investors can make informed decisions about the ability of a company to create or add value. But if companies conceal, exaggerate, or disguise important aspects of performance, participants, including investors, will be misled. A failure in company performance *and* corporate governance can be lethal, leading to a crisis or collapse more sudden, severe and widespread than would have occurred if standards of good governance had been observed.

In 2002, the United States experienced seven of the 12 largest bankruptcies in its history—until that record was broken in 2008. A partial list of major corporate collapses in the last eight years includes the names of companies held in high esteem until better knowledge about their performance and condition became available:

- Enron, Tyco, Global Crossing (USA, 2002)
- Royal Ahold (Netherlands, 2002–2003)
- Parmalat SpA (Italy, 2003)
- Thai Petrochemical Industries (TPI) (Thailand, 2002–2003)
- Bear Sterns, Lehman Brothers, AIG (USA, 2007–2008)
- Satyam Computer Corporation (India, 2008–2009)

While the company managers in each of these cases were able to blame unexpectedly adverse commercial developments for the cause of their failures, in most cases it became increasingly

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<sup>7</sup> As will be shown later, there is considerable evidence that companies that do not follow the standards of good governance tend to perform worse than those that do.

clear that managers had avoided measures to disclose or reveal – or had taken steps to conceal important information about the companies’ true condition and performance from reaching directors, shareholders or the general public. The suddenness and severity of the ensuing collapse, bankruptcy, or loss of shareholder value were caused therefore not only by unexpected market forces but by market forces adjusting to information that contradicted – in the extreme – previous information.

The extent of these failures raised legitimate questions about the accuracy and integrity of accounting and audit firms and the effectiveness of regulatory oversight. The failures also renewed interest in the role of the board of directors, who, according to the principles of corporate governance, should be in a position to spot potential problems and question anomalous results. Were decisions and actions that imperiled a company taken with full knowledge and approval of the board of directors? Were directors misled, or were they derelict in their responsibility? Some examinations made after the fact include statements by some directors indicating that, in retrospect, they recognized that they had not been not fully aware of the particular gravity of the situation, and so felt no need to be exceptionally diligent in examining or questioning management or seeking additional information.<sup>8</sup>

To address weaknesses that contributed to the wave of corporate collapses between 2002 and 2004, some economies instituted reforms. These included reforms of accounting and auditing standards to preclude conflicts of interest, as well as reforms holding company officers accountable to a higher standard of financial information. After only a few years, however, there was a succession of crises and collapses among major financial institutions. Once again, in some cases, statements from one or more directors indicated that—in retrospect—they recognized that they were less than fully cognizant of the financial situation of their companies, especially of the risks of new financial instruments being traded.

Causes of the recent financial crisis are still being assessed and analyzed, but it appears that managers in some financial companies were disguising the extent of liabilities and risks. Again it appears that directors—not to mention the investing public—were not fully aware of financial conditions or risks. Reforms are once again being explored, including reforms that demand that directors exercise a moderating influence on company decisions, especially risky ones.<sup>9</sup> Directors, can, of course, legitimately adopt or endorse a high risk, high-yield strategy, without necessarily violating the principles of good governance. However, at the very least, directors should ensure that policies and decisions that could put a company’s survival at risk are examined and deliberated much more attentively.

## **What Is Necessary for Corporate Governance to Work Better?**

To strengthen corporate governance one must understand the basic purpose and functions of governance and the context in which companies and corporate governance operate. For example, other entities, such as audit firms and securities trading exchanges, influence the functioning of corporate governance. Supporting institutions and the prevailing environment for business, including openness to international standards and influences, determine in part what can reasonably be expected from those directly responsible for a company’s corporate governance—chief officers, directors and shareholders. In the first subsection below we examine conditions necessary for companies and good governance to develop and flourish in

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<sup>8</sup> Gillespie, John and David Zweig, *Money for Nothing*, Free Press, 2010.

<sup>9</sup> As in engineering, the main function of a “governor” (director) is to moderate the tendency of some operations to exceed recommended performance parameters.

the first place. We then explore reasons why governance can fail or underperform even when basic conditions are favorable.

### ***Preconditions for Effective Corporate Governance***

Despite their growth and spread, corporations have not flourished everywhere and in all times and situations. Certain conditions favor the development of corporations and of corporate governance. Among those conditions are the following:

1. The rule of law.
2. General peace, order and macroeconomic stability.
3. A market-based economy including competition.
4. A growing number of educated savers interested in more options for their savings.
5. A government in favor of a business-enabling environment.
6. An enhanced capacity for financial accounting and reporting and maintenance of public records, such as shareholder registries.
7. Financial institutions and intermediaries competing to serve investors and corporations.
8. A secondary market for trading securities.

The first six conditions can be considered prerequisites for the emergence of corporations and a robust capacity for corporate governance. Rule of law is a basic condition as opposed to anarchy or the arbitrary exercise of force. Special laws are also needed to protect the institutions of private property and the principles of ownership and contracts. Laws that encourage market-based enterprise and competition are yet another requirement, along with laws recognizing and regulating the role of securities and securities trading.

The establishment of these laws improves the climate for private sector and market-led activities. Businessmen will choose to organize themselves using the best legal options available. Gradually, more and more firms, even older, successful family-owned private firms will recognize the advantages of choosing to incorporate. As the number and size of corporations continue to grow, so will the need for educated and qualified persons to serve as:

- Managers
- Corporate directors
- Regulatory staff (both public and private sector agencies)
- Accountants and auditors
- Financial analysts and investment advisers
- Financial journalists and other media
- Investment fund managers

In brief, an economy intent on accelerating growth by encouraging the development of companies funded by private investment must have in place laws and institutions that allow private companies and private investment to flourish. Prime among these institutions is an educational system that meets the demand for occupations such as those listed above, and that enlightens the general public about the value of saving and investment for themselves and for the economy in general. Corporate governance can be an important element in an educational system that raises awareness of citizens' roles and responsibilities.

### ***How Can Corporate Governance Be Strengthened?***

Efforts by APEC member economies and other economies to strengthen corporate governance fall into two categories:

1. Efforts that focus on the roles and accountability of the three constituent elements of corporate governance by improving communication and ensuring useful checks and balances among shareholders, directors and managers.
2. Efforts that focus on improving supporting institutions, such as audit agencies and regulatory agencies.

In some economies, more attention has been paid recently to options in the first category: what can be done to strengthen corporate governance at the shareholder and director levels. Figure 1-1 illustrates the perception and argument by some shareholder rights and governance experts that corporate governance as practiced today in some companies has diverged from the basic precepts of company laws. The discretionary powers of CEOs have increased at the expense of the proper role of directors and the voice of shareholders in the selection of directors. These powers also give a CEO more control over policies and decisions about dividends, retained earnings, and executive compensation (lower portion of Figure 1-1) as well as over risk management policies and other strategy-level decisions that should be the purview of the board of directors. The CEO can be particularly dominant in companies where shares are widely held and no single shareholder or allied block of shareholders controls a majority of the voting shares. This is one reason why shareholder advocacy has focused on increasing the number and role of independent directors on company boards and increasing shareholder voice in director selection.<sup>10</sup>

To strengthen supporting institutions, some economies have reformed laws and regulations or issued government-sponsored guidelines. But, as we show below, many important improvements arise in the private sector. Trading exchanges, professional associations of directors, and shareholder rights associations are spearheading efforts to improve corporate governance. Their recommendations and guidelines may not have the force of law but they do influence standards and practice and help keep directors, shareholders and regulators abreast of issues, problems and solutions.

Of course, interest in corporate governance is not confined to the APEC economies, which have benefited from governance guidelines and standards that reach across borders for the sake of the common goal of economic development.

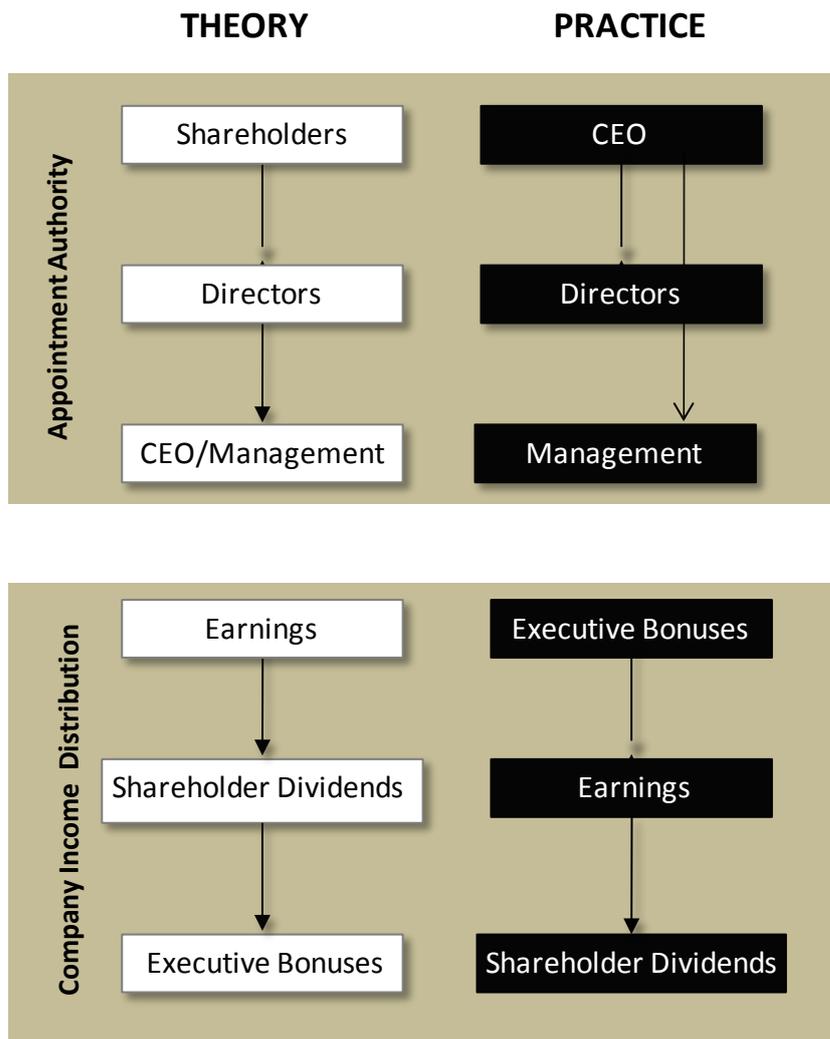
## **RECENT INTERNATIONAL REFORMS**

The Asian Financial Crisis of 1997–1998 prompted leaders around the world to examine the role of corporate governance and implement reforms that would make governance a more effective safeguard against crisis-inducing behavior. Leaders from many economies helped develop the OECD Principles of Corporate Governance issued in 1999 to serve as guidelines for improving corporate governance. Many economies have used the guidelines to draw up and adopt reforms in governance law, regulations and practices. Subsequent episodes of corporate collapse, including the global financial crisis of 2007–2009, have kept governance in the spotlight and renewed concerns about how to make governance more effective—either by reform or by better implementation and enforcement of existing rules, or both. In the following subsection we review reform developments and initiatives that have gained acceptance in the international community

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<sup>10</sup> Observers note the tendency of shareholders to react passively to the increasing power of a CEO as long as the market price of shares is increasing; they become concerned and active only when prices cease to rise or begin to decline.

Figure 1-1  
*Corporate Governance Models*



## Governing Institutions and Rules

### *International Standards and Best Practices: OECD Principles*

The OECD Principles of Corporate Governance have set the standard for many economies.<sup>11</sup> The principles were developed by OECD member economies in consultation with non-member economies, including developing and transition economies.<sup>12</sup> They were revised in 2004 in light of experience with implementation and the experience of economies reforming governance in response to concerns about shortcomings and failures of corporate governance revealed in 2001-2002 in Europe and the United States. The Preamble to the Principles states the nature of corporate governance and its purpose:

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper

<sup>11</sup> <http://www.oecd.org/dataoecd/32/18/31557724.pdf>

<sup>12</sup> A number of APEC economies participated in the OECD-led effort.

incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring (p. 11).

The principles are intended primarily for publicly traded companies. Thus, the financial and institutional resources required to comply with many of the principles can be considerable and full compliance can be challenging for companies lacking access to capital markets. Nevertheless, the principles can clearly benefit a range of company types and sizes including medium-sized companies that are not publicly traded, large nonprofits, and state-owned enterprises. There are six basic principles:

1. Ensuring the basis for an effective corporate governance framework
2. The rights of shareholders and key ownership functions
3. The equitable treatment of shareholders
4. The role of stakeholders in corporate governance
5. Disclosure and transparency
6. The responsibilities of the board

These principles are elaborated through numerous subprinciples. The following paragraphs present a fuller statement of the basic principles and comments on selected subprinciples under the first four principles.<sup>13</sup>

**1. *The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.*** An element of a related subprinciple is *Supervisory, regulatory and enforcement authorities should have the authority, integrity and resources to fulfill their duties in a professional and objective manner.* Authorities in many economies, including some of the world's wealthiest, have been less than effective in enforcement. Vigilance by shareholders and directors should be the first line of defense of corporate governance rules, and if such vigilance is lacking, there is one less reason to expect supervisory and enforcement authorities be aware of a potential problem and marshaled to address it. Insufficient shareholder vigilance may be due to rapid growth in capital markets and in the number and size of listed companies. Given the large and steadily growing number of publicly traded companies in many economies, it has become increasingly difficult for supervisory and enforcement authorities to monitor corporate governance effectively and routinely. Moreover, coordination among such authorities has often been lacking or ineffective, especially when criminal prosecution is required.

**2. *The corporate governance framework should protect and facilitate the exercise of shareholders' rights.*** A related subprinciple defines basic shareholders' rights:

Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; and 6) share in the profits of the corporation.

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<sup>13</sup> A complete statement of the principles themselves are available in several languages at the OECD website: <http://www.oecd.org/daf/corporateaffairs/principles/text>

One subprinciple in this area has been problematic. *Shareholders should have the opportunity to ask questions to the board... to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.* What “reasonable limitations” should be is sometimes misunderstood. Agenda items and resolutions proposed by shareholders should be those that are properly matters for shareholders’ determinations. Sometimes shareholders have attempted to propose matters that are not within the purview of shareholders but of the board of directors or company management. Some shareholders have not recognized the limited decision-making power of shareholders inherent in the separation of ownership and management in a publicly traded company.

In most economies, shareholders’ key governance responsibility and inherent decision-making power under company law relate to the important right to elect members of the board of directors. Elections usually occur annually. Other matters for shareholder determination occur infrequently, if at all. Examples include voting on a merger or acquisition, sales of a substantial portion of a company’s assets, or changes in shareholders’ rights through amendment to the company charter or bylaws. Thus, shareholders’ powers are subject to significant limitations in scope and timing. If shareholders are not content with the performance of a company in which they own shares, they have two options: (1) elect at the next voting opportunity new board members who will seek to change the direction of the company, or (2) sell their shares if they can find a buyer for a price they deem acceptable. Since the latter option is limited for shareholders whose shares do not have a liquid market, even if publicly traded, a competent and effective board of directors is of paramount importance.

In the company laws of some economies, the right of shareholders to “remove” members of the board is exercised in ways not conducive to good governance. Some laws state that directors may be removed at any time by a majority or supermajority vote.

With respect to executive compensation, a subprinciple states that: *Shareholders should be able to make their views known on the remuneration policy for board members and key executives.* This is consistent with the movement in some economies for shareholders to have a “say on pay” especially in light of what many believe is excessive compensation for directors and key executives of companies whose revenues or share prices have not increased (or have even declined) in comparison to the relevant market index or the shares of rival companies.

Another part of the same subprinciples provides: *The equity component of compensation schemes for board members and employees should be subject to shareholder approval.* Equity components can be in the form of grants of shares that can be sold immediately or whose sale must be deferred, or in the form of stock options. The grantee of stock options has the right to purchase company shares in the future at a stated price. This gives grantees an incentive to raise the prevailing share price before the right to exercise the option expires. This is consistent with

This subprinciple states in part:

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The OECD Principles are a model for many economies. In July 2002, a committee of seven financial service and business organizations chaired by the National Supervisory Commission of Companies and Securities (CONASEV) of Peru issued the Principles of Good Governance of Peruvian Companies. Five parts are very similar in concept and wording to the OECD Principles, although principles for the responsibilities of the board of directors are much more extensive than those of the OECD Principles.<sup>14</sup>

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<sup>14</sup> [http://www.bvl.com.pe/descarga/principles\\_good\\_governance.pdf](http://www.bvl.com.pe/descarga/principles_good_governance.pdf). Also see in Chapter 3 of this report Peru’s IER for additional information about not only July 2002 principles, but also general management rule issued by CONASEV in 2003.

the theme of “pay for performance” and aligning executives’ incentives with shareholders’ interests of company performance over the medium rather than short term. Especially in economies where executive compensation has become controversial, shareholders’ awareness has increased along with exploration of reforms to avoid disconnects with performance or excessive incentives for risk taking and short-term performance only.

Another subprinciple provides:

Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights.

Institutional investors in this context refer mainly to collective investment funds that typically have hundreds or thousands of investors. These include pension funds, investment funds and hedge funds. Disclosure of corporate governance and investment policies as urged by the subprinciple is straightforward and relatively easy to comply with. By contrast, the exercise of ownership influence by beneficial owners of investment funds or pension funds presents challenges. In principle, investment fund investors, if not satisfied with disclosed policies by fund management companies on corporate governance and voting, could sell their investments. However, beneficiaries of company-sponsored pension funds are usually more captive.

Advocates of shareholders’ rights have proposed that shareholders in investment funds be empowered to exercise their own voting rights rather than having fund managers automatically exercise voting rights with respect to shareholdings in companies in which investment funds invest. Indeed, a subprinciple is that *Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares*. This is considered appropriate because of the conflicts of interest faced by many institutional investor managers, particularly those who are part of financial services conglomerates.<sup>15</sup> The requirement to disclose management of any such conflicts of interest is acknowledged in a subprinciple of Principle 2.

**3. The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.** A subprinciple states:

Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.

A frequent complaint in this area relates to remote voting at shareholders’ meetings. Some economies do not permit shareholders to vote by telephone, facsimile transmission, or the Internet and recognize only votes delivered in person or by proxy at shareholders’ meetings. Unless there is a contested election, proxy voting is usually facilitated only for voting as recommended by the board of directors of a company. Direct remote voting may allow for a more diverse expression of shareholder interests. Foreign shareholders frequently complain that prior notice of shareholder meetings is inadequate. This problem could be easily remedied by posting a notice on a company’s website and extending the period of prior notice when it is too brief to allow effective marshalling of shareholders’ interests.

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<sup>15</sup> This could be an area where terminology in use by different APEC economies has different meanings, resulting in different practices. In some economies the expression “nominees and custodians” might not be understood as including trustees or custodians designated by investment fund managers.

Another subprinciple is that *Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.* Abusive related-party transactions between company directors or executives and the company that they serve have been a source of significant losses for companies in many economies. Disclosure of family and business relationships of directors and executives has improved in many economies, but disclosure of other “outside” interests such as a director’s relationship to third parties with prior business interests has not been an area of significant progress.

**4. *The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active cooperation between corporations and stakeholders in creating wealth, jobs and the sustainability of financially sound enterprises.*** The practical import of this principle is stated succinctly in a subprinciple: *The rights of stakeholders that are established by law or through mutual agreements are to be respected.* Another subprinciple states:

Stakeholders, including individual employees and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and their rights should not be compromised for doing this.

This refers to encouragement of and protection for so-called “whistleblowers”. Usually the best source of information about corporate misconduct is a person with firsthand knowledge of the wrongful action and information from such individuals has been important in prosecuting illegal conduct in some economies. While not advocated in the principles or subprinciples, it is increasingly popular among companies to establish a comprehensive code of ethics that describes avenues for whistleblower communication and investigation of allegations, and that prohibits retaliation against whistleblowers when information is communicated in good faith.

**5. *The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company.***

**6. *The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board’s accountability to the company and the shareholders.*** These self-explanatory principles are supportive of each other and of the first four principles.

Experts from many economies took great care in elaborating these principles, which are available in multiple languages on the OECD’s website.<sup>16</sup>

### ***Financial Sector Assessment Program Benchmarking***

The Financial Stability Forum (now the Financial Stability Board) designated the OECD Principles of Corporate Governance as one of 12 international standards for sound financial systems.<sup>17</sup> The principles provide a framework for information exchange about implementation within OECD and other economies, and this framework has formed the basis for the corporate governance component of the World Bank and IMF Financial Sector Assessment Program

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<sup>16</sup> The official text of the 2004 revision of the principles can be downloaded in more than a dozen languages from the OECD website: [www.oecd.org/daf/corporateaffairs/principles/text](http://www.oecd.org/daf/corporateaffairs/principles/text)

<sup>17</sup> The Financial Stability Forum was established in 1999 to coordinate national financial authorities and international standard setting bodies in developing and promoting regulatory, supervisory and other financial sector policies. In 2009, the institutional underpinnings of the Forum were strengthened and its membership expanded, and it was renamed as the Financial Stability Board.

(FSAP). The FSAP includes a report on the observance of standards and codes (ROSC) with respect to the principles. Ten APEC members have had a ROSC on corporate governance—two were published in 2006, two in 2005, and the other six between 2001 and 2004.<sup>18</sup> In general, the now-dated ROSCs found that most economies had basic rules for corporate governance standards and requirements in place but that company practice fell short of full compliance and enforcement was weak.<sup>19</sup> Many APEC economies have since used the assessments as a basis for reforms.

## CORPORATE GOVERNANCE AND SUSTAINABLE ECONOMIC GROWTH

We began this chapter with insights gleaned from APEC’s 2008 meeting in Lima about the importance of corporate governance to member economies. All the presentations on governance at that meeting support the following conclusion: *Corporate governance is important because it helps generate and sustain economic growth.* **Corporate governance:**

- Improves performance at the company level;
- Helps an economy attract foreign investment;
- Leads to better allocation decisions by intermediaries in capital markets;
- Improves long-run returns for savings including contractual savings (e.g. pensions, insurance and retirement funds); and
- Broadens and deepens understanding among professionals and investors about the value of self-reliance, responsibility and accountability.

Most economies find it worthwhile to pursue these benefits. Note, however, that investment and capital market benefits all depend on the first benefit—better performance at the company level—combined with improved accounting and disclosure practices. Most observers of company behavior find the link between good corporate governance and company performance obvious. At the very least, the historical record of company scandals, earnings restatements, share price collapses and bankruptcies are regularly linked to failures in corporate governance. Less well known is the statistically based evidence of a significant correlation between measures of corporate governance and company performance. A sampling of such studies is presented in Table 1-1.

Table 1-1

*Excerpts from Studies of Corporate Governance and Company Performance*

Source	Excerpt
Gompers, Paul A. and Joy L. Ishii and Andrew Metrick. 2003. Corporate Governance and Equity Prices. <i>Quarterly Journal of Economics</i> 118 (1). February. 107-155. <sup>20</sup>	We used an incidence of 24 indicators of governance to construct a “Governance Index” as a proxy for shareholder rights for 1,500 large firms in the 1990s. A hypothetical investment strategy that bought firms in the lowest decile of the index (Strongest shareholder rights) and sold firms in the highest decile of the index (Weakest rights) would have earned abnormal returns of 8.5% per year during the sample period. We also found that firms with stronger shareholder

<sup>18</sup> Chile; Hong Kong, China; Indonesia; Republic of Korea; Malaysia; Mexico; the Philippines; Peru, Thailand; and Viet Nam.

<sup>19</sup> Chapter 3 of this report contains information on the state of corporate governance in [16] APEC members.

<sup>20</sup> Also available through Wharton Financial Institutions Center.

Source	Excerpt
	rights had higher firm value, higher profits, higher sales growth, lower capital expenditures and made fewer corporate acquisitions.
Brown, Lawrence D. and J. Mack Robinson and Marcus L. Caylor. 2004. Corporate Governance and Firm Performance. December.	We created a broad measure of corporate governance, Gov-Score, based on a new dataset provided by Institutional Shareholder Services. Gov-Score is a composite measure of 51 factors encompassing eight corporate governance categories: audit, board of directors, charter/bylaws, director education, executive and director compensation, ownership, progressive practices, and state of incorporation.
Agrawal, Anup and Shaiba Chadha. 2003. Corporate Governance and Accounting Scandals. July.	The probability of restatement of earnings is lower in companies whose boards or audit committees have an independent director with a background in accounting or finance.
Biao Xie, Wallace N. Davidson, III, and Peter J. DaDalt. 2003. Earnings management and corporate governance: the role of the board and the audit committee. <i>Journal of Corporate Finance</i> , Volume 9, Issue 3. 295-316.	Supporting an SEC Panel Report's conclusion that audit committee members need financial sophistication, we show that the composition of a board in general and of an audit committee more specifically, is related to the likelihood that a firm will engage in earnings management. We conclude that board and audit committee activity and their members' financial sophistication may be important factors in constraining the propensity of managers to engage in earnings management.
Black, Bernard S., Jang, Hasung, Kim, Woonchan. 2004. Predicting Firms' Corporate Governance Choices: Evidence from Korea. University of Texas Law School Working Paper No. 39.	Well-governed firms in Korea traded at a premium of 160% to poorly governed firms.
Black, Bernard. The Corporate Governance Behavior and Market Value of Russian Firms. <i>Emerging Markets Review</i> , Vol. 2, March 2001.	A study of Russian firms showed that a worst-to-best improvement in corporate governance predicted an astronomical 700-fold (70,000%) increase in firm value

The works noted in Table 1-1 are persuasive, but not all academic work supports the same conclusion. Rather there is vast disagreement among academics and other experts and practitioners over the best way to measure governance and its relation to performance. In fact, measuring aspects of good corporate governance and progress in economic governance presents problems for scholars, for proponents of governance reforms, and for agencies that monitor standards of behavior. One lesson offered by both scholars and proponents is that formalistic approaches to measurement (e.g., boxes ticked) are not very useful.

Measurement difficulties pale, however, when compared to the damage that the failure of a single company can wreak on shareholders and bondholders, damage that in some cases infects financial sectors and even entire economies. While good governance will not prevent companies from underperforming or failing, it will help an economy's participants distinguish between companies that create value and those that do not—and that will help ensure that the competitive process contributes to economic growth.

Globalization has raised the stakes for leadership and sound decision-making in top companies in every economy, and corporate governance has a role to play. Improving governance requires more education and more responsibility on the part of major corporate stakeholders. Alternatives to private-sector led efforts to improve governance—such as vastly increased regulation or state intervention—pose risks and costs that could hobble a company and an economy. Effective and more efficient regulation is surely needed, but any economy that can

eliciting better corporate governance using cultural and ethical norms will lighten its enforcement burden.

Better corporate governance can start with a single company. Every director and CEO in every company should be keenly aware that lapses in governance hurt more than a single company's balance sheet and shareholder value. In large companies, poor governance can generate a shock wave of failure that cascades throughout a sector. Likewise, the benefits of sound governance can extend far beyond a company's boardroom and financial statements by contributing to sustainable economic development in an economy and even beyond its borders.

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# 2. Legal and Institutional Foundations of Corporate Governance in APEC Economies

## INTRODUCTION

APEC economies have a diverse array of corporate organizational structures and surrounding legal environments and are interested in improving corporate governance within these environments. Our systems vary from the stated goal of corporate governance to most every element of implementation; they are a microcosm of the evolutionary processes that define corporate governance.

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Yet, there is debate about how corporations should prioritize the interests of their stakeholders, how to set up corporate structures, or about what structures are optimal, in the APEC region or the world. Corporate governance may include competing corporate governance systems in different economies, because corporations in one economy may have to adjust their governance structure to compete with those from another. Recognizing the variety of answers to these questions and the lack of agreement on what corporate governance is, what does it mean to "implement good corporate governance"? Australia's description of corporate governance challenges powerfully illustrates these ambiguities:

For example, how should the primary duty of the board to equity holders be balanced against rules designed to provide protection to debt holders? What role should corporations play in promoting corporate social responsibility? Another challenge facing Australia's corporate governance system is whether shareholders participate to a sufficient level to assist good corporate governance practices.

Every APEC economy is actively engaged in work to answer these questions for their own economic system and adjust to their changing environment. For example, Korea and Chinese Taipei list corporate social responsibility (CSR) as a reform priority, and Russia talks about providing safeguards for creditors, government and society at large, a broader definition. Canada also notes the increasing importance of CSR in corporate governance.

## PURPOSE

This chapter describes the breadth and range of APEC's diverse treatment of corporate governance problems, from legal systems to enforcement institutions and future reform efforts. By describing their function, rationale, and how they interact with another, we hope to increase understanding among and within APEC economies of how corporate governance works in APEC, as well as avenues for future reform. The particular features of each system are detailed in the IER section of Chapter 3. While a detailed discussion of each is not possible here due to space constraints, some examples are highlighted. The responsibilities of the various actors in corporate governance vary widely. Their evolution takes different turns and is path-dependent.

The end goal is not that a company has five directors or seven auditors; what matters is how well individuals in companies are motivated to work for the gain of the defined stakeholders and, through that, society as a whole.

In the APEC spirit of learning directly from the business community, we have prepared Table 2-1, which is based on a survey of numerous ABAC members on priorities for strengthening the economic and legal infrastructure in the Asia-Pacific region ordered by level of interest (average of the reversed rank in degree of disinterest, “Low,” and rank in degree of strong interest, “High”).<sup>21</sup>

Table 2-1

*Level of Interest in Ways of Strengthening the Economic and Legal Infrastructure in APEC*

Rank	Field
1	Facilitation of Incorporation
2	Improvement of Information Disclosure and Transparency for Creditor Rights
3	Corporate Information Disclosure
4	Harmonization with Application of International Accounting Standards
5	Enhancing Alternative Dispute Resolution Mechanism
5	Improvement of Competitive Market and Regulation of Anti-Competitive Practices
7	Facilitation of Fund Raising by Strengthening Creditor Rights
7	Measures to Promote Reorganization and Restructuring
9	Facilitation of Business Combination
10	Unification of Model Laws each APEC Economy Adopts

Disclosure and transparency are the functional result and method of good corporate governance. Investors want to know what is happening at their company to make sure they get the benefit of the bargain they strike with their agents and co-investors. They may prefer to have foreign subsidiaries, partners and joint ventures use the same accounting standards for easy understanding and disclosure and to reduce fraud, fiduciary breaches and agency costs via easier detection, punishment and dismissal.

Why are investors not so keen on model laws in this field? Unification of model laws in this diverse, evolutionary field would exemplify formalism, and as noted in Chapter 1, formalism is not helpful in corporate governance.

Similar priorities were identified in the AEPR in 2006:

The specification of shareholder rights; accounting and disclosure standards that encourage transparent business practice and the provision of appropriate information to the market; clearly defined duties for directors that ensure they behave in a transparent manner to protect shareholders’ investments; clearly defined procedures that define how boards may come to a decision and manage risk, and a regulatory, judicial and legal system capable of enforcing breaches of good corporate governance practices.

We write this chapter under this mandate and informed by businesses’ expressed interests in this field, beginning with a discussion of how some regulations in APEC economies act to

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<sup>21</sup> Survey conducted among 60 ABAC Japan member companies in Feb. 2010 on their expectations for strengthening economic legal infrastructure in the Asia-Pacific region. The response rate was 25%, with 15 total companies providing detailed information on their priorities in this area.

resolve basic problems in corporate governance to facilitate competition and thus improve corporate governance through market pressure.

## **COMMON ELEMENTS FOR CORPORATE GOVERNANCE IN APEC ECONOMIES**

### **Desirable Attributes of Well-Functioning Systems**

#### ***Shareholder Rights and Protections***

How do APEC economies address agency costs, the classic corporate governance problem described in Chapter 1 where an agent fails to act in accordance with their principal's (corporation) best interests in mind? Economies impose fiduciary duties upon managers as a shareholder protection. APEC economies establish fiduciary duties through their corporate code or case law depending on their civil or common law legal system. HKC is transitioning from its former common law approach to a more code-based approach for the duty of care of directors. Disclosure and transparency help enforce these duties through legal mechanisms and reputational discipline.<sup>22</sup> For example, transparency can reveal majority shareholders' influence over subsidiary companies and limit their ability to abuse their power through reputational discipline, making it expensive to attract a minority investment partner for future projects. When owners see the impact of their managers' actions, they can alleviate agency costs through corrective measures. Thus, any effective transparency measure is a shareholder protection and right.

Shareholders generally have two rights: the right to beneficial ownership of their investment and the right to vote in proportion with their ownership in any elections where their class of stock has a voting right, sometimes for directors directly or through a single elected officer. However, some APEC economies, such as Hong Kong, China (HKC), have shareholder votes by number of registered owners by default and only count shares upon request.<sup>23</sup> Also, the right to beneficial ownership may not give shareholders the right to receive any cash, because the right to declare a dividend or conduct stock repurchase may belong to management directors. However, if a dividend is declared, shareholders may have the right to receive it in accordance with whatever rights they have specified. The company may immediately owe them this money once directors declare their intention to pay a dividend. Shareholders may also have the ability to sell shares if the company is public and there are no unusual circumstances preventing their exercise of this right, and all economies limit this right, for example for insiders or in certain times and transactions. Also, shareholders may have appraisal rights to get some particular price when they sell their shares against their will.

Voting rights are meaningless without a meeting, so HKC and others allow shareholders to call for or require a shareholder meeting.

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<sup>22</sup> When performance is revealed to be good or bad through disclosure and transparency, the responsible director or officer's professional reputation is affected and their subsequent job responsibility and compensation accordingly. This sets up incentives for directors and officers to perform well and improve governance. This process is generally abbreviated as "reputational discipline" in the corporate governance context.

<sup>23</sup> The Listing Rules require listed companies to hold all shareholders' vote on a poll (Rule 13.39(4)).

### ***Shareholder Equality***

Another corporate governance problem is that majority shareholders have control and may use that control to influence the company to other shareholders' detriment or neglect. In APEC economies, a corporation's managers owe their fiduciary duties to all shareholders, not just one. However, when managers are selected by one shareholder, they may not act in accordance with this duty. One response is to establish a legal principle of shareholder equality, as Japan has done.<sup>24</sup> Another is to impose fiduciary duties on majority shareholders to protect minority shareholders.<sup>25</sup> Korea notes its Chaebols have worked to protect minority shareholders following the financial crisis to gain investment, an example of reputational discipline. Chile promotes free float for pension fund investments. Russia's highest free float is 49% and average control stake is 69%, posing unique challenges. APEC economies employ numerous methods. Peru even allows shareholders with 25% ownership to get registered and trade shares.

### ***Regulatory Restraint***

Businesses may have specific, targeted concerns on corporate governance, and these concerns vary. Regulations benefit or hurt some companies more than others, so they may impact which companies flee to a low-regulation jurisdiction or remain or seek out the premium of listing in a market said to be more rigorous. Corporate governance regulations in the capital market context, including government and exchange listing requirements and the related regulatory burden are financially significant for companies listed there and their competitors not listed there. Excessive regulation leads to capital flight and competitive disadvantage. Regulators, including stock markets, would be well-served to consider these possibilities. Mexico has noted this potential, in particular expressing concern about reform fatigue.

## **Choices to Provide Flexibility in Corporate Governance**

No matter the reform, some companies wish to take advantage of it and others do not. In that context, what can APEC regulators do to ensure that their regulation helps and do not hurt business in their economy?

One solution is choice. Some investors and companies may prefer a board with a separate audit committee and majority independent directors. Others may prefer a board mainly composed of experienced insiders to better guarantee a long-term vision for the company's future. For some companies one structure works better, and for others another works better. Instead of forcing each company to conform to a particular structure, something the business world clearly does not want as expressed by its disinterest in unifying model laws; a regulator may introduce a new structure as a choice. Companies may choose to switch, and this switch, if positive, provides comparative advantage over competitors. Forcing companies to adopt an uncompetitive structure degrades their long-term performance and imposes needless transition costs. Some APEC economies introduce corporate governance reforms as an option or choice to resolve this. Korea's KOSDAQ allows an audit committee or full-time auditor, for example. HKC allows choice among IFRS or Hong Kong Financial Reporting Standards.<sup>26</sup> Singapore likewise allows choice among IFRS, SFRS and US GAAP.

Japan in 2002 provided its companies with a new management institution choice. The amended Commercial Code gives a "large company" the option to adopt a new corporate governance

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<sup>24</sup> Article 109-1 of Japan's Company Law.

<sup>25</sup> For example, a fiduciary duty has been imposed on majority shareholders in numerous states in the United States, Canada and many other APEC economies.

<sup>26</sup> Companies with a primary listing must use either IFRS or HKIFRS (see Rule 4.11). Companies with a secondary listing in Hong Kong can use US GAAP (see Rule 19.39).

system. A company adopting such a system must establish committees, majority “outside” directors, and have no corporate statutory auditor. At a Company with Committees, the board may delegate a substantial portion of its management authority to officers. By providing companies with this option, Japan allowed successful companies to retain their existing board structure and continue to do business without interruption, the best result in corporate governance regulation. They also provided companies the option to change to a competing style of corporate governance. Some changed; some did not. However, all companies have to compete with other governance structures and are subject to market discipline. This allows the economy to benefit from governance options without disruption. By making a corporate governance change optional, APEC economies can get the full benefit of a regulatory mandate without much cost. Optional corporate governance reforms should be seriously considered in future reform efforts.

A related concept is the “comply or explain” system employed in Australia, Malaysia and other economies. Companies can choose not to comply with a rule, but must give a reason. This preserves flexibility, though it also adds some disclosure and compliance burden.

## Overview of Other Specific Guidelines

What corporate governance is and for whose benefit corporations ought to work is a controversial, unresolved question. Corporate governance systems vary significantly and continue to evolve, so a universal set of principles, if overly detailed or formalistic, may in some instances limit rather than enhance reform efforts. However, they also serve as a valuable reference. Reflecting this concern, the OECD Principles note as follows:

[The Principles’] purpose is to serve as a reference point.

To remain competitive in a changing world, corporations must innovate and adapt their corporate governance practices so that they can meet new demands and grasp new opportunities. Similarly, governments have an important responsibility for shaping an effective regulatory framework that provides for sufficient flexibility to allow markets to function effectively and to respond to expectations of shareholders and other stakeholders.

[Corporate governance] relationships are subject, in part, to law and regulation and, in part, to voluntary adaptation and, most importantly, to market forces.

The OECD Principles have served APEC, the EC and some economies as valuable reference material. Thailand has made nuanced, positive use of the OECD Principles in evolving its system. However, Japan does not use them for reform, and Korea and Canada listed other influences for their reforms. HKC is emphasizing public input for its revised law. The more specific Principles could be implemented as options within an economy’s existing framework. Companies can thus capture any benefit that they find, resulting in more optimal adoption.

The Principles are written in the context of publicly traded companies in OECD member economies between 1999 and 2004. Also, some APEC economy views, such as those of Japan’s business community expressed in a comment to the drafters,<sup>27</sup> were not adopted in the formulation process. OECD economies have not implemented or adopted these principles wholesale. However, they are recognized as one of the 12 Key International Standards for Sound Financial Systems by the Financial Stability Board, which includes 11 APEC member economies. Leaders of the G20 economies re-committed to implementing the 12 Key Standards at the London G20 Summit in 2009.

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<sup>27</sup> <http://www.keidanren.or.jp/english/policy/2004/014.html>

## Director Selection and Board Composition

Who appoints directors within APEC economies varies widely, including (i) a shareholder-elected company chairperson or president, (ii) shareholders directly, and (iii) government officials or a designated independent person or institution for state-owned enterprises (SOE). New Zealand has an administrative body to decide who may be a director of a public company. Indonesia's 2007 revision requires a "Shariah Supervisory Board" for companies employing Islamic Finance, and generally employs a two-tier structure with a board of commissioners overseeing the board of directors.

In the case of SOEs, a government appointed director or officer, even if not a government official or former government official, has fiduciary duties. However, given the opportunity to profit in a direction different from the government's wishes, such managers might breach their fiduciary duty to comply with the wishes of the government that appointed them. Also, regulators in an economy with both SOE and private enterprises may be tempted to punish the private enterprise and reward the state enterprise, destroying value in private companies. These drawbacks must be weighed against the public interest in having state-owned enterprises in an industry sector or economy. One mechanism to address these concerns is Russia's "professional attorney" institution, an SOE public governance institution on the board. Advantages may be found to outweigh disadvantages for public utilities, transportation monopolies and other crucial infrastructure. Chinese Taipei notes that it exercises its shareholder rights over SOE and encourages them to privatize. Korea, Canada and Russia also actively manage their SOEs on behalf of the public, though Russia notes it is moving away from this practice.

An increase in audit committee or statutory auditor independence coupled with sophisticated financial backgrounds reduce accounting irregularity frequency.<sup>28</sup> Accounting irregularities and scandals have a massive negative impact on stock. Despite this positive, increasing insider directors and the number of directors may have a positive impact on corporate performance. The combination of these results suggests that the better board structure for APEC is to have a certain number of inside directors who know the company inside and out, and in addition, independent verification that audits are conducted properly. Chinese Taipei, for example, requires 1/5 of certain large company boards to be independent, reflecting a balanced use of the concept. Peru requires none, except for some industries which must have one independent director. Chile requires one director for certain companies. HKC and Viet Nam require 1/3. Singapore's code requires 1/3 and its exchange requires two. New Zealand requires 1/3 rounded down, with an audit committee majority. Mexico requires 1/4 with an all-independent audit committee. The Philippines requires two or 20%. Indonesia's audit committees have an Independent Commissioner and two more outside members. Malaysia requires all non-executive audit committees and 1/3 independent directors overall.

Corporate governance scandals can arise in companies regarded to have independent boards of directors and excellent corporate governance prior to the scandal: Enron won an award for good governance right before being revealed to have defrauded its employees and investors.<sup>29</sup> Citigroup's outside directors' lack of familiarity with their business may have prevented them from monitoring their traders' risk management practices, magnifying the economic crisis. These incidents illustrate the dangers of formalism in corporate governance regulation. Chile cites its good corporate governance for its avoiding derivatives and much of the negative impact of the financial and economic crisis.

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<sup>28</sup> See, e.g., "Audit committee, board of director characteristics, and earnings management", April Klein, *Journal of Accounting and Economics* Vol. 33 Issue 3, August 2002.

<sup>29</sup> *Chief Executive* magazine in 2001 ranked Enron as #3 in the best five boards in 2000.

## **Corporate Governance Rules in the Case of Insolvency**

APEC economies vary widely in dissolution and liquidation rules. Dissolution and liquidation occur when a company lacks sufficient funds to pay off all of its existing obligations, but may be chosen by a company which no longer wishes to do business as a means to divide its accumulated profits equitably among debtors and shareholders. In corporate governance, dissolution and liquidation are primarily relevant for their impact on fiduciary duties.

Companies that lack sufficient funds to pay their outstanding obligations are said to be in the “Zone of Insolvency.” In the Zone of Insolvency, shareholders’ claim on company assets may be close to or at zero. When shareholders have limited hope to recover anything from their investment, if directors’ only fiduciary obligation were to shareholders, they would take the most high-risk high-return measures possible because the downside for shareholders would be zero and the upside positive; in other words, any gamble is a good gamble for shareholders in the Zone of Insolvency. To prevent such skewed incentives, APEC economies may adjust fiduciary duties both to shareholders and debt holders. This can be very complicated, as different types of creditors and shareholders may have very different incentives and views.

Russia recently reformed its insolvency system to provide creditors with avenues to seek compensation from directors and “shadow directors” and reduce administrative cost.

## **Corporate Structures and the Facilitation of Business Combinations**

### ***Improvement of Procedures Re Mergers, Spin-Offs and Business Transfers***

Mergers, spin-offs and business transfers can trigger corporate governance requirements specific to the situation. For example, a supermajority shareholder vote may be required, or a company may become public or go private as a result, fundamentally changing applicable corporate governance requirements and shareholder protections. Also, an active M&A market is an integral part of many economies’ corporate governance systems.

APEC economies are improving procedures in this area. For example, Korea has provided flexibility in merger consideration.

### ***Measures to Promote Reorganization/Restructuring***

Reorganization and restructuring allow corporations with liquidity problems to continue operating under a new capital structure. This impacts corporate governance when it results in a change of control. Whether existing management can continue in a restructuring varies within and among economies. New managers may disrupt the existing business, further destroying value available for creditors to recover. Leaving existing managers in place enables them to continue to destroy value. Both narratives may be true, so APEC economies may have a judge or the creditors determine who should run the company. This uncertainty helps keep directors engaged and motivated in a failing company to retain control. Economies promote reorganization and restructuring to get companies back to normal, profitable operations and corporate governance situations or to unload failing businesses to those better able to run them.

## **Transparency Promotion through Corporate Information Disclosure**

### ***Obligation to Make Timely and Accurate Disclosure of Important Corporate Information***

Transparency is essential and core to corporate governance because it enables governance quality measurement and so allows market pressure and other forces to remedy problems. Public disclosure and transparency requirements focus on public companies, with a few exceptions. Economies mandate disclosure for material or price sensitive information, including HKC, the United States, and others.

How much disclosure they must make and when varies by economy, stock exchange and even shareholder citizenship. Disclosures must be accurate, but how accurate, what is “material,” punishments for disclosure inaccuracies, and who is punished vary. Insiders face significant temptation to profit from securities sales by delaying or failing to disclose negative information, so APEC economies generally impose criminal responsibility on those responsible for disclosure inaccuracies. Even criminal punishment fails to deter all fraud. Corporate codes and guidelines can also work to help guide companies in developing internal governance systems to prevent fraud. For example, audit committees with independent directors with financial experience have been shown to be highly effective in reducing opportunities for fraud. Many companies have adopted institutions in line with such guidelines even when not required by law, suggesting that they can be helpful. Of course, if a particular set of guidelines or principles were required by law, it could also prevent companies from developing new principles and systems for internal governance simply because they are formalistically different from those required, even if better at preventing fraud.

However, the primary function of transparency and disclosure for public companies is to help the public, including shareholders and analysts, to understand how a company is doing. Companies periodically disclose financial statements and other information. These disclosures allow outsiders to verify corporate and management performance. Companies must also disclose significant events, such as transactions involving most of a company’s assets. Some corporate governance issues are significant enough to require shareholder approval.

Disclosure that improves corporate governance helps the market and regulators discipline management. The market and regulators comprise an enormous range of financial literacy, so it is difficult to determine the optimal disclosure format and level. Disclosure-related expenses can exceed millions of US dollars per year. Companies may choose to list in less burdensome economic zones and exchanges for this reason. However, disclosure’s benefits for market efficiency and governance have substantial value. If regulators carefully consider the target audience, they may be able to limit regulatory excesses and improve disclosure quality.

### ***Fostering Specialist Groups***

Requiring companies to disclose material and accurate information on a regular basis cannot guarantee uniform and understandable information. Meaningful transparency requires a strong accounting profession that understands how and when to account for and disclose financial information, a legal profession that understands when disclosure is necessary and what is significant to the business, and a close working relationship with trust between professionals and management. Certified professional organizations help maintain good disclosure standards. Such organizations can discipline members who fail to uphold these standards and incentivize members to act diligently and loyally. The accounting profession in particular serves an important function as a gatekeeper for public companies. The need to regulate must be balanced

with the importance of professional confidentiality to give professionals the opportunity to help management fulfill their duties.

Chinese Taipei, Japan, the US and most other APEC economies have a system for chartering or certifying licensing professional accountants (CPA). CPAs are employed for external audits and as internal or statutory auditors/audit boards, helping enforce compliance in two layers. APEC economies also have legal professionals to guide companies in conforming with corporate governance requirements.

### ***International Accounting Standards Harmonization***

Harmonization with international accounting standards is an issue that gains and loses momentum with some regularity but is relevant to corporate governance. IFRS are not universally accepted in APEC, and debate continues about their merits versus other accounting standards. In particular, there is a corporate governance concern that some accounting standards may be better at encouraging long-term, stable growth than at focusing on one accounting period's earnings.

However, there are also significant benefits to harmonizing accounting standards. Korea, Malaysia and New Zealand take advantage of these benefits via IFRS adoption. Some companies are listed on multiple exchanges around the world, and different economies and stock exchanges may require disclosure of financial documents under a particular set of accounting rules, requiring each such company to convert their financials and make different accounting judgments for each exchange multiplies administrative overhead. Harmonized standards allow further professional qualification internationalization. Universal accounting standards backed by universal professional performance standards would allow easy comparison among companies, enabling more efficient capital allocation and global corporate performance, as long as the standard chosen incentivizes long-term performance over earnings manipulation or smoothing. Such standardization increases pressure on companies by forcing them to compete for capital with all other competitors for capital in the world. However, if the standard chosen allows fraud to go undetected for some period, the world might suffer a global simultaneous accounting scandal crisis. Given the events of the past decade such a scenario should be considered. Thus, it may be important to maintain diversity in accounting standards, or even to allow companies to choose which standards to use along with choosing which economy and stock exchange in which to compete for capital.

Chinese Taipei will require listed companies to convert to IFRS by 2013.

## **Finance Facilitation from the Perspective of Corporate Governance**

### ***Stock Issuance Regulations for Investor Protection***

Securities issuance and related fraud is an issue in every economy in the world. Private corporations are subject to much less oversight and disclosure requirements than public corporations, so they may not issue securities for sale to the general public. This forces companies to either become public and subject to public company corporate governance requirements or to confine their pool of investors to sophisticated, wealthy persons.

Stock issuance regulations require issuers to produce detailed documents explaining investment risks, what their company is, its financials, and who is involved in management. This ensures investors can inform themselves before they buy stock. Chinese Taipei recently strongly recommended listed corporations form a risk management committee for investor protection.

### ***Stock Ownership Transparency***

Stock ownership transparency is fundamental to corporate governance, because it ensures voting rights are exercised by their owners. Transparency of stock ownership limits stock voting fraud. Public companies are required to make disclosures about who owns their stock and how much as relevant to governance: who owns more than some threshold, any voting agreements, etc. The institution enforcing transparency and voting rights varies and overlaps in APEC economies among securities exchanges, government agencies, shareholder lawsuits, proxy agents, news media and others.

Stock ownership is now almost entirely electronic, e.g., in Indonesia's KSEI, though paper certificates remain in some APEC economies. Sophisticated and secure computer systems at securities settlement and clearing houses maintain registries of who owns how much of what, and actual certificates are rarely transferred. Individual investors buy stock through financial institutions that hold stock in their street name in trust for the investor. This improves ownership security and efficiency and makes it easier to prevent voting fraud. When an entity making a proposal attempts to get a shareholder list to communicate their proposal, it is easier to gather the information and does not require physically locating stock certificates. This improves corporate governance by making it easier to use and verify shareholder voting rights.

Russia's constitutional court dealt with share ownership fraud issues extensively in 2010; this is detailed at 6.2 in Russia's IER.

### **Executive Compensation and Incentive Programs**

Incentive compensation is a hot issue in corporate governance. Some argue that incentive compensation align incentives between managers and stakeholders so that management gets "some skin in the game" and acts accordingly. Conceptually, this should help corporate performance by reducing agency costs, and it does improve director effectiveness. However, problems arise in implementation. Stock options grant dates, the differences between stock options and stock, and repricing options following negative shifts in share price have all spawned corporate governance scandals. It can be difficult to understand how these programs impact ordinary shareholders. How to avoid incentive abuse is an unsolved problem in corporate governance; however, incentive compensation remains an important partial solution to the problem of agency costs widely used in APEC economies. Australia's legislative framework empowers shareholders to limit excessive termination compensation, since such compensation is given at a time when the executive is not able to affect the future performance of the company.

## **ENFORCEMENT INSTITUTIONS AND PROCESSES**

### **Courts and Corporations**

#### ***General Courts versus Specialist Courts***

Judicial enforcement mechanisms form the final backstop for corporate governance – when reputational discipline, internal governance procedures, financial audits, legal compliance and counsel, market discipline, listing requirements, corporate governance codes, and financially savvy independent directors or auditors, have failed and a perceived abuse has occurred, a lawsuit is brought against the alleged abuser. This type of enforcement can powerfully impact participants' incentives, and the specter of a lawsuit or enforcement is always on the minds of directors in board meetings.

Some economies employ ordinary courts exclusively in corporate governance, relying on lawyers, accountants and bankers to brief judges on the facts and law just like any other court case. Other economies have specialist courts that deal with corporate governance issues. Still others have no specialist courts per se but have allocated some courts or judges more corporate law cases and so developed some level of specialization.

Specialist courts help keep a separate court docket so that ordinary criminal and civil cases are not delayed or crowded out by complex business litigation. Also, judges who handle these cases exclusively, or more than usual, are able to more quickly understand a case and deliver consistent results, making litigation more efficient. Specialist courts' advantages have caused jurisdictions worldwide to consider adopting some level of specialization. Peru is an example of a partially specialized system.

Some APEC economies with civil law systems focus more on regulatory enforcement than some APEC economies with common law systems. Many blend these approaches, as well. These distinctions are of uncertain impact, but they change the way corporate governance enforcement looks to the public. Viet Nam has settled all enforcement issues without court cases. Viet Nam has accomplished this by providing for Alternative Dispute Resolution (ADR) to settle disputes among shareholders, companies, regulators and other third parties in its 2009 revised Corporate Governance Code.

### ***Methods for Integrating Specialist Knowledge into the Judiciary***

A related issue is the training of judges generally. In some economies, judges are career judges with no other work experience. It can be difficult for such a judge to understand corporations without additional specialized education or training. Employing judges with career experience related to corporate law can help improve the quality and consistency of decisions. Thus, whatever court system an economy operates under, specialized training for judges in aspects of corporate governance is likely to be important for effective adjudication.

Whether or not an economy employs career judges, there are several other ways to integrate specialist knowledge in the judiciary. For example, economies can and do have continuing legal education requirements for judges. These can include training on corporate governance related legal issues to help improve the quality and consistency of legal decisions. Thailand, Malaysia, and Chinese Taipei, for example, have education programs on corporate governance for their judiciary.

## **Administrative Regulation and Enforcement**

Administrative agencies can be heavily involved in regulating and enforcing corporate governance restrictions. A benefit of this approach is that it can help reduce the burden on courts resulting from corporate governance issues and encourage settlements. Administrative action can be swift and powerful compared with a lawsuit, which helps bolster the impact judicial enforcement can have on incentives to avoid situations where a lawsuit or administrative action might arise. On the other hand, administrative action (and judicial enforcement) can be so powerful that the remote possibility of such action can consume much of management's consciousness even when they are not engaged in suspect action, hurting business competitiveness. Even more care than judicial enforcement should be taken in administrative enforcement because of its immediate impact, particularly in the case of suspected securities fraud, and the lack of judicial process required before that impact occurs.

Administrative regulation is the prime mover in corporate governance regulation in many economies. For example, the transparency and disclosure requirements discussed above are implemented primarily through administrative enforcement in many economies. Thus,

administrative enforcement is pervasive in the discussion throughout this year's AEPR. Administrative regulation is also particularly important where shareholder lawsuits cannot be effectively pursued. Also, administrative agencies often operate the disclosure system itself, playing a central role in the information distribution chain.

### **Private Sector Regulation and Enforcement—Governance-Related Requirements for Companies to be Listed on Major Trading Exchanges**

Various major securities exchanges impose corporate governance related requirements to list on their exchange. For example, NASDAQ and the NYSE in the US have detailed requirements for independent directors, defining them and their role and mandating numbers, as well as many other requirements. In Chinese Taipei, the Taiwan Stock Exchange and GreTai Securities Market impose corporate governance rules in addition to their Company Law. For example, Chinese Taipei's and Malaysia's exchanges mandate a few hours of governance training each year to continue listing. Canada and Singapore have self-regulating corporate governance systems and no mandatory director training. The Philippines requires director training. New Zealand's NZX writes its own rules subject to override by a minister. Exchanges enforce via public reprimand, delisting, or fines. However, corporate governance-related delisting is rare. Mexico and Peru, for example, know of none.

Exchanges may adopt these requirements for a number of reasons, including to preempt legislation that might be more burdensome, to guarantee a higher minimum standard of transparency and honesty in management and thus function as an exchange to certify some quality in its listed companies. Securities exchanges in APEC contribute to corporate governance in two ways: firstly, when an exchange imposes high, good listing requirements, domestic companies are required to adopt those corporate governance practices or leave the stock market entirely, so this can improve the governance of the pool of public investment opportunities; and second, international companies in economies with low listing standards can opt to be "bonded" to a higher standard in another economy, which is said to improve their governance.<sup>30</sup> However, there is also evidence that the "bonding" effect is overstated or even negative, calling listing requirements into question as a viable corporate governance institution.<sup>31</sup>

When exchanges mandate corporate governance practices, they limit access to a capital market to companies unwilling or unable to adopt these practices. In doing so, they may increase those companies' cost of capital. They also eliminate opportunities for investors in those exchanges to participate in these businesses. On the other hand, they may succeed in getting companies to change the way they run themselves in order to obtain a lower cost of capital. Whether they succeed in doing so will depend on whether the harm from adopting a new corporate governance requirement in disrupting the business or reducing the effectiveness in corporate governance is more or less than the benefit from reducing the cost of capital. They also give their government a powerful incentive to spread their corporate governance practices throughout the world, since if the practices the exchanges require do not spread, the stock exchange cannot compete for foreign listings. The Bursa Malaysia has requirements beyond those in the corporate code. Chile's Santiago Stock Exchange does not impose such

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<sup>30</sup> "Racing towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance", John C. Coffee, Jr. *Columbia Law Review* Vol. 102, No. 7 (Nov., 2002), pp. 1757-1831

<sup>31</sup> See, e.g., "Cross-Listing and Corporate Governance: Bonding or Avoiding?" Amir N. Licht, *Chicago Journal of International Law*, Vol.4 No.1, 141.

requirements, keeping itself open to different governance systems. Russia's RTS and MICEX have listing requirements including governance requirements, and it also has more than 10 voluntary codes of corporate conduct for industries.

## **Fraud and Fiduciaries**

### ***General Law on Fraud versus Securities Fraud and Related Institutions***

Corporate governance deals with fraud because fraud represents a breakdown in relationships central to corporate governance: those between shareholders, directors and management. General law on fraud is tort law, which typically says that if one person knowingly makes a material misstatement in order to manipulate another who reasonably relies on this information to the financial advantage of the one and to the other's detriment, one is liable for these damages. Securities fraud comes in a wide variety of forms, from corporate fraud to pump and dump schemes, Ponzi schemes, late trading, boiler rooms, accountant fraud, etc.

For corporate governance, the most important type of securities fraud involves financial statement disclosure, as mentioned above. Misstatements are enforced against individuals and companies, and penalties in APEC economies range from fines to civil judgments, incarceration and execution. Enforcement mechanisms include administrative bodies, courts and securities exchanges.

### ***Fiduciary Duties***

In the company law of nearly every APEC economy, managers such as board members may have a duty to act with complete loyalty to the interests of shareholders, or creditors in the zone of insolvency. Also, directors may have a duty of care. Breach of these duties may result in legal liability, so managers go to great lengths to avoid situations where they might be perceived as breaching these duties. When a decision is to be made that might impact their personal interests, a director might not participate in a vote or even leave the room or phone call during the discussion. Boards with multiple members with potential conflicts might set up a committee with only directors perceived to be neutral to make such decisions as compensation, whether to accept an offer to purchase all or a significant part of the business, or to audit the corporation's financial statements and choose independent auditors to review them. Companies might have an internal auditor or audit-board structure. To avoid breaches of the duty of care, boards make sure to discuss alternative courses of action in meetings before making a decision and to record that they did so in the meeting minutes.

Employees are usually disciplined through internal corporate policies. However, this does not always suffice to deter employees from self-dealing. To supplement these measures, some economies impose fiduciary duties on senior employees such as officers and even non-officers. Well-functioning internal controls, with well-separated purchase decisions and auditing functions, for example, help reduce opportunities for employees to steal. Compensation can also be arranged to mitigate incentives to act against the corporation's interest, although there may be natural limits to this approach. Korea is in the midst of reform on director liability via its Commercial Act. It is attempting to define outside directors, expand the definition of director self-dealing, and deal with the problem of corporate opportunity usurpation, problems which persist globally. Chile's 2010 reform dealt with these issues. Other economies are also engaged in reform efforts.

### ***Shareholder Lawsuits: Extent of Effectiveness and Possible Improvement***

In those APEC economies which allow them, including Korea, Chinese Taipei and the US, shareholder lawsuits have a real impact on corporate governance, although they remain rare in Russia, which legally regulated them in 2009. When a board is discussing a major decision, they carefully discuss both options and record that this discussion occurred, as discussed above under fiduciary duties.

Chinese Taipei has an administrative enforcement system via lawsuit, the Securities and Futures Investor Protection Center. It may initiate an action against management on behalf of the company or a lawsuit to dismiss a director or supervisor.

## **Policing versus Reputational Discipline**

### ***Judicial Enforcement Mechanisms for Various Frauds and Breaches of Duty***

#### ***Monetary Penalties and their Appropriate Level, Incentives***

When a corporate insider engages in self-dealing or for the benefit of a third party at the expense of the corporation, they may or may not be caught and punished. If the only possible negative consequence of this conduct were forfeiture, requiring them to return the money would not suffice to deter insiders from self dealing because they would get caught less than 100% of the time. However, most economies have additional penalties such as incarceration and execution, so it may be that returning the money is enough.

#### ***Criminal Penalties' Role in Corporate Governance***

Criminal penalties are a very harsh punishment for economic crime. Considering the fine line between a freewheeling businessperson and a target of a corporate fraud investigation, it may seem excessive to impose criminal penalties in this field. However, financial penalties, and even criminal penalties, are not enough to deter all corporate wrongdoing. Removing criminal penalties might result in even more corporate governance abuses. Different economies draw the line in different places on this issue, but with a few exceptions noted above, flagrant securities fraud and corporate governance abuses lead to criminal penalties.

### ***Market Discipline's Role in Corporate Governance***

#### ***Directors and Management***

If civil and criminal penalties do not suffice to deter businesspeople from corporate wrongdoing, how do corporations function at all in support of stakeholder value? Reputational and market discipline prevents fraud and encourage good performance. Once managers or directors have been publicly exposed to have acted against their company's interest, their career may be over. Having prominent businesspeople in a company in a position of responsibility signals to potential shareholders that this company is doing things right. The story of J. P. Morgan,<sup>32</sup>

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<sup>32</sup> Ramirez, Carlos, "Did J.P. Morgan's Men Add Liquidity? Corporate Investment, Cash Flow and Financial Structures at the Turn of the Twentieth Century", *Journal of Finance* 50 (1995) 661.

directors in Meiji Japan,<sup>33</sup> and China's FoxConn's reputation in manufacturing exemplify this effect. How to create a business environment where prominent directors flourish and promote good corporate governance has not been perfected, but thinking about what good corporate governance means for individuals involved and their incentives can provide clues to inform future policy efforts.

In this context, there are a variety of approaches in selecting future company leaders. Selecting them internally improves performance by: (1) motivating employees to promote stakeholder value in pursuit of their career; and (2) motivating companies to invest in their employees' skills to develop them as future leaders within the firm, benefitting company performance. On the other hand, diversifying corporate leadership has also been identified as an important factor to maintain and improve a company's performance, especially in its international efforts.<sup>34</sup>

### *Shareholders' Role in Governance and Markets*

Canada cites shareholder self-governance as the most important corporate governance enforcement institution, in line with much academic work on shareholder rights.

Shareholders' role in governance through voting more particularly is discussed below. Briefly, shareholder self-governance involves giving shareholders a vote to determine which corporate governance practices are good for their company. Beyond voting rights, shareholders can also impose pressure by selling poorly governed stock, depressing share prices. Once share prices are fairly low, groups may buy the stock to pressure management to adopt better governance practices or give up management to a group who will, thus earning a profit through exercise of their voting rights and improving corporate governance. In this way, giving shareholders self-governance rights in corporate governance matters can create a virtuous cycle for better governance.

### *Limits on Market Discipline's Power*

As discussed under the topic of criminal and civil enforcement above, for many or even most individuals the potential for reputational harm may not suffice to prevent corporate governance failures. However, civil and criminal enforcement can complement market discipline by making a public record of corporate governance failures. If enforcement were clear and consistently applied, it could deter bad governance along with reputational discipline. Unfortunately, clear and consistently applied enforcement in corporate governance is uncommon.

### *Mechanisms to Improve Market Discipline on Corporate Governance: Transparency, Disclosure and Markets for Corporate Control*

#### *Transparency and disclosure in the context of market discipline on corporate governance*

Markets depend on public information to determine securities prices, which in turn determines a company's capital cost. The spread between a company's capital cost and its return on investment determines its fate in the long term. Greater transparency serves not only to expose companies which are doing badly or doing bad things but also to expose companies which are

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<sup>33</sup> "The Value of Prominent Directors: Lessons in Corporate Governance from Transitional Japan", Y. Miwa and J. Mark Ramseyer, Harvard Law School John M. Olin Center for Law, Economics and Business Discussion Paper Series (1999)

<sup>34</sup> J. Stewart Black and Allen J. Morrison, "A Cautionary Tale for Emerging Market Giants", Harvard Business Review (2010.9)

doing well and acting in the interest of their stakeholders. Mandatory disclosures thus help reward the good and punish the bad, in tandem with market discipline for corporate governance.

Chinese Taipei's Securities and Futures Institute conducts an Information Transparency and Disclosure Ranking among all listed companies annually, helping impose market discipline to improve transparency and disclosure.

#### *Markets for corporate control*

When functioning well, a market for corporate control is a highly effective form of market pressure for corporate governance. Management is subject to pressure to treat shareholders as well as they would treat themselves because if they do not, an outsider could buy the company.

Regulation in corporate control markets varies widely, but briefly, APEC economies with well-functioning corporate control markets have the following characteristics:

1. One can buy a company against the management's wishes if the shareholders think it is the best offer they are likely to get and a good time to sell;
2. Management has a meaningful opportunity to negotiate on behalf of the shareholders with the would-be purchaser for a better price; and
3. Offers are not permitted to be coercive, that is, pressuring shareholders to accept early for fear of getting a worse deal later in the event of a squeeze-out.

Markets for corporate control keep management focused on adding value, so some economies are working on ways to develop such a market. For example, Japan has issued guidelines<sup>35</sup> for "Poison Pill" shareholder rights plans so that companies can develop means to negotiate with a would-be hostile acquirer with an appropriate time limit and shareholder vote to ensure that the acquirer has an opportunity to make their case. Cross-shareholding and shareholder voting in these situations is another area Japan has focused on as it develops its market for corporate control. HKC has an active takeover market.

## **AREAS FOR FURTHER REFORM IN CORPORATE GOVERNANCE LAW AND REGULATION**

### **Corporate Governance Improvement Tacks**

#### ***Shareholder Rights and Responsibilities (right to dissent and obtain payment for shares, procedure for executing dissenter's rights, etc.)***

APEC economies have been making rapid and powerful progress in the area of implementation and improvement of commercial and corporation laws surrounding shareholder rights and responsibilities.

Some economies provide rights for dissenters or to obtain other payment for shares. For example, if a merger is approved by the management but some shareholders believe the transaction is unfair, these shareholders may elect to have their shares appraised to get what

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<sup>35</sup> "Guidelines Regarding Takeover Defense for the Purposes of Protection and Enhancement of Corporate Value and Shareholders' Common Interests", available at [http://www.meti.go.jp/policy/economy/keiei\\_innovation/keizaihousei/pdf/shishin\\_hontai.pdf](http://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/shishin_hontai.pdf)

they argue is their due rather than accept the terms of the merger. Alternatively, when a company is owned largely by a single shareholder who wishes to make that company a wholly-owned subsidiary, shareholders may be subject to a squeeze-out, a forced sale of their shares. Chile, New Zealand, the US and others provide for squeeze-out and redemption rights. Appraisal rights serve as a check on management's self-interest and help shareholders get a fair deal.

### ***Role of Shareholders in Corporate Governance***

Shareholders are the owners of the beneficial interest in a company, so they have a strong incentive in improving the company's financial performance. Chile's Pension Fund Administrators are one APEC example of institutional investors helping corporate governance. However, in companies with dispersed ownership, shareholders may have difficulty organizing to exercise their influence to control a company. This problem is an issue in any economy with dispersed shareholder ownership, a particular issue in any economy that moves from predominantly controlling shareholders or institutions with block ownership toward more dispersed shareholders. Several methods have been proposed to improve this. Some examples include to make shareholder proposals and proxy fights generally less costly to make, or even free in some situations; to allow shareholders to amend corporate bylaws through shareholder proposals at annual or special meetings; or otherwise allocate additional controls to shareholders. Korea, for example, allows shareholders with >3% of outstanding shares to make written proposals. Russia allows >2% shareholders to add agenda items to meetings. Peru has a special administrative organization that can call general or special shareholders' meetings. Viet Nam allows >10% shareholders to make proposals, or less as per the bylaws.

The management-centric view of corporate governance resists these efforts, arguing that directors are better able to make decisions in the interest of shareholders than shareholders due to directors' superior knowledge and experience. However, studies show convincingly that increased stock ownership corresponds to better firm performance, and the reason for appears more likely to be alignment of incentives than superior information.<sup>36</sup> If increased director stock ownership leads to better governance, shareholders might make better decisions for the company than directors to the extent an informed and procedurally fair shareholder vote can be held. In that light, economies committed to the vision that shareholder participation improves corporate governance will be interested in reforms that enable shareholders to add items to the company proxy statements and agenda for general shareholder meetings. The US has also recently shifted in this direction with the Dodd-Frank Act (USA, July 2010). However, many US academics, judges and directors retain the management-centric view, and the appropriate degree of shareholder rights remains a hotly contested issue. Chinese Taipei and HKC have Company Act provisions for minority shareholders to make proposals at board meetings and other protections. APEC economies would be well served to carefully analyze these sorts of proposals and ensure that they are made available to shareholders as an option for self-organization. Similarly, Japan's corporate law and guidelines have enabled shareholders to vote on a takeover proposal within a short time.<sup>37</sup>

The United States this year followed this movement by enabling the SEC to make rules to allow shareholder proxy access. This is significant because it reduces proxy fight expenses; with access to company proxies, activists can run more governance battles and impose

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<sup>36</sup>“Does Skin in the Game Matter? Director Incentives and Governance in the Mutual Fund Industry”, Martijn Cremers et al, *Journal of Financial and Quantitative Analysis*, 44:1345 (2009).

<sup>37</sup> In HKC, no shareholder approval is required for a general offer to take over a company (except for privatizations).

competitive pressure on management. While the bill restricted governance freedom in listed companies by requiring compensation committee directors be all independent, with a few exceptions, it left a few areas open after a lively debate. This in turn means the new proxy access regulations, if and when effected, allow shareholders to vote to that increase competition among corporate governance styles within the US on such issues as whether to impose majority voting in director elections or to combine or separate the board chair and CEO positions.

### ***Equitable Shareholder Treatment***

Japan has enacted and enforced laws to develop a market for corporate control, shareholder proposals and votes to add another competitive marketplace to effect corporate governance reforms. Japan enacted a law providing for a “principle of shareholder equality” in its new Corporate Code. The Bull Dog Sauce case saw this law applied in a hostile takeover / “poison pill” case. The case held that treating shareholders differently does not violate this principle where the treatment results from a proper shareholder vote and the differently treated shareholder receives appropriate compensation. The hostile acquirer received an amount calculated to compensate for dilution at a price equivalent to its proposed tender offer price, which the Supreme Court found reasonable and not in violation of the meaning behind the principle of shareholder equality. Japan’s new law as interpreted by the Supreme Court may result in a highly efficient market for corporate control, as long as *ex ante* poison pill plans coupled with cross-shareholdings are subject to reasonable limits.<sup>38</sup> On the other hand, Japan continues to have less hostile takeover activity than is typical for economies with an active market for control.

### ***Disclosure and Transparency***

Disclosure and transparency measures are necessary to have share prices that reflect company value and thus impose market pressures on management to operate in the stakeholder interest. Disclosure and transparency measures are the most powerful tools for corporate governance.

In principle, shareholders could elect directors who would engage in disclosure beyond that required to enable them to make informed decisions on whether to buy or sell stock, or to buy or sell the company as a whole. In practice, this does occur to some extent. However, shareholders may face organizational difficulties when there are many small, dispersed shareholders with limited time to invest in that particular company, so there is a natural role for administrative disclosure regulation, and administrative agencies are therefore typically the most important player in this space. However, regulators are not in the best position to determine what information shareholders want and in what format. Legally mandating a greater voice for shareholders, at least in determining what kind of disclosure they get, might achieve better disclosure and transparency than those required by exchanges and government regulation. Canada’s approach to shareholder self-governance, for example, and the US’s new approach under Dodd-Frank may lead their companies in this direction.

### ***Duties and Responsibilities of Governing Bodies (Board, Officers, Auditors)***

The appropriate role, duties and responsibilities of individuals involved in corporate governance is the subject of an ongoing policy debate around the world and laws (and bylaws and listing requirements) on the subject remain in flux. As discussed above, these individuals

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<sup>38</sup> Nels Hansen, “Japan’s First Poison Pill Case, Bulldog Sauce v. Steel Partners: A Comparative and Institutional Analysis P.166 *Journal of Japanese Law*, No.26 2008 (J.Japan.L.(no.26/2008) (abstract available online at: [http://www.djjv.org/ZJapanR26\\_01.htm](http://www.djjv.org/ZJapanR26_01.htm)).

are subject to numerous legal requirements, and their structure is regulated more or less loosely in various economies and public and private regulators within economies, from those which provide a sample of choices (Japan for large public companies) to those open to a variety of structures (HKC's stock exchange), as well as some innovative new structures (Russia's Professional Attorney). Some economies, individual companies and regulators are trying out separating CEO and Chairman functions; and some are moving to multi-tiered structures with different functions. How this area can be further improved is widely debated and uncertain, but it remains active as described above and in the IERs.

### ***Financial Accounting***

One trend in accounting is to move toward fairly valuing a company's labor force with training specific to the company as an asset. For example, some companies have elaborate training programs to ensure that everyone from the lowest levels to the highest levels in a company has a shared understanding of how the business works. This can help ensure that directors, for example, understand how the business works and thus can effectively act in their role as gatekeepers. This in turn improves corporate governance. By including such items in accounting assets, good corporate governance may be encouraged and reflected in a company's balance sheet.

On the other hand, the capitalization of internally generated assets is currently not allowed under the International Financial Reporting Standards, despite the fact that it is indeed a growing trend. It is also arguable as to whether there is a need to fairly value a company's workforce for those who have attended training, since these value increases may be internalized to share value in the capital markets already.

### ***Efforts toward Harmonization, Benefits and Drawbacks***

Some stakeholders, however, such as labor unions in Europe, are interested in harmonization to expand their role in corporate governance internationally. Such harmonization efforts aim to reflect such interests' views in the way corporations are run globally and reduce the competition corporations have from foreign corporations lacking, e.g., labor union involvement in governance so that these corporate governance provisions cause less harm to their own corporations' competitiveness. Drawbacks of these efforts, though, include hurting economic productivity internationally by reducing competitive pressures on management in the same way. Another drawback is reduced competition among corporate governance forms resulting in inefficient management structures and inappropriate regulatory burdens. A majority of APEC economies including the United States, Japan and Canada, have moved away from harmonization in this field in their respective reform efforts, perhaps to avoid the economic harm from a homogenous, bloated corporate governance regulation system that fails to account for differences among industries, economies, company size and legal system, or perhaps because each economy's corporations' diverse array of governance styles and evolutionary history means harmonization efforts in corporate governance are misguided. Also, HKC is not part of a move to harmonize corporate governance standards as a goal, and in amending their requirements, HKC has benchmarked itself against standards adopted in other jurisdictions, particularly the UK, but not with a view to harmonization.

However, efforts to learn from different legal systems' corporate governance structures and regulatory systems can be useful to solve domestic problems. Capacity building projects that explain how a system works in context could be useful.

### ***Align Management Incentives with Shareholders through Compensation Structure***

The discussion of shareholders' role in corporate governance above has significant implications for compensation and corporate governance. If directors perform better when they are more closely aligned with shareholders, and our goal is to have management for long-term growth, the following compensation scheme could mitigate short-termism and governance scandals:

Mandate that all compensation above the cost of living be in the form of restricted stock automatically sold over the course of 5-10 years after the stock grant. Also, require that this stock position not be pledged or offset by any other means.

This simple solution has the disadvantage of taking away flexibility in incentive compensation. If this were implemented in one economy alone and that economy's managers were highly mobile, this could risk some talent flight. Still, if the compensation is competitive in total value, and if the managers are relatively liquid, good managers should stay and bad managers should leave. Also, the basic premise of mandatory corporate governance regulation is that we cannot trust companies to handle self-governance. Therefore, to avoid future scandals and do away with the need for a tremendous amount of enforcement and regulation surrounding insider trading, we suggest regulators consider requiring incentive compensation be limited to restricted stock along these lines to better align management incentives with shareholders.

Japan enacted an improvement to its stock-option system in 2001. The restrictions that had been placed on persons to whom stock options could be granted and the maximum number of shares that could be issued by exercise of stock options and the permissible exercise period no longer existed. Moreover, though a special shareholders' resolution was still necessary to authorize certain facets of stock options, the breadth of those facets had been reduced.

The United States' Dodd-Frank Act increases compensation disclosure, adds claw-back provisions for incentive compensation related earnings restatements, requires all-independent director compensation committees, and once in a while to give the shareholders the right to express a non-binding opinion on executive pay. It remains to be seen whether this will rationalize executive compensation, but this is an innovative reform effort. The act also provides for hedging disclosure, to show whether management is permitted to offset their financial interest in the company with other financial instruments. This is essential to make any incentive compensation scheme meaningful. Economies with similar concerns about executive compensation and corporate governance will find aspects of this legislation useful to consider.

Australia is working on a two-strike system to strengthen its shareholder vote on pay. It may also require shareholder approval to declare an open board position closed. Canada also has seen increased "say on pay" activity, with 35 companies adopting the system. Japan recently required management compensation disclosure where in excess of 100 million yen per year in public companies, and HKC has a proposal to require a director compensation report even for some private companies. Indonesia makes director pay public.

# 3. Individual Economy Reports Summary

This chapter presents individual economy reports (IERs) from 18 APEC member economies prepared between May and August 2010. We first present a summary of the reports' contents; the complete IERs follow.

## **INSTITUTIONAL FEATURES OF CORPORATE GOVERNANCE AND COMPANY PROFILES**

### **Legal and Institutional Basis of Corporate Governance**

Responding APEC economies report that the legal basis for corporate governance in their economies rests on a body of “company law” supplemented by securities laws, stock exchange listing requirements, corporate governance codes, and regulations of securities commissions or integrated financial sector regulators.<sup>39</sup>

Some economies have developed voluntary guidelines or codes of corporate governance, and some government regulations or stock exchange listing rules require listed companies to explain their degree of compliance with voluntary corporate governance codes, often in companies' annual reports.

The Philippines is one of the member economies in which the judiciary has explicit authority to enforce disputes between a company and its shareholders, including with regard to the election of directors.

Since 2000, many APEC economies have amended laws to strengthen provisions for corporate governance. In 2008, Thailand amended Securities and Exchange Act (SEA) to provide a clearer scope of fiduciary duties, stipulate sanctions for breaches of those duties, and strengthen the rules governing related party transactions including stronger protection for investors' interests. Some, like Indonesia, have established economy-wide bodies or provided existing bodies of public and private sector representatives a new mandate to develop rules for good governance. In some cases, governance strengthening was prompted by the revelation of alarming company misconduct that current practices, laws and regulations had not prevented. In other cases, amendments arose as host economies and international finance institutions cooperated in promoting good governance as a way to increase foreign direct investment and economic growth. Several economies report that the OECD Principles of Corporate Governance have been useful.

### **Number of Publicly Traded Companies and Market Capitalization**

From 2005 to 2009 the number of publicly listed companies remained consistent in most APEC economies, increasing or decreasing by less than 10%. The global financial crisis of 2008–2009

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<sup>39</sup> Some respondents provided information on the content and enforcement of securities laws on matters more closely connected with trading of securities than with corporate governance. To the extent that securities law and practice directly affect basic corporate governance matters highlighted in this report, they are included in the discussion.

probably played a role in this lack of growth. At least five economies—Australia, Malaysia, Mexico, New Zealand and Hong Kong China<sup>40</sup>—reported delistings, but no economy reported a trend in “going private,” whereby companies voluntarily choose to delist or fail to qualify because of a declining number of publicly traded shares. From 2005 to 2007 total market capitalization on APEC stock exchanges grew strongly then in 2008 declined markedly—by 30 to 40%. By 2009, economies reported market capitalization as much as 20% lower than the 2007 peaks.<sup>41</sup>

## Corporate Governance Rules and Practices

Responses to Annex 2 of the questionnaire submitted for this year’s IER are provided in Table 3-2. Overall, responses indicate that company transparency regarding financial condition and operations is good. One exception is the conformity of financial statements with International Financial Reporting Standards (IFRS). Some economies, especially those where the standards will become mandatory by 2013, say that meeting the standards is a challenge. But even where the standards are not mandated, a number of listed banks and companies with significant international investors are adopting them to help attract and retain international investment.

The rights of shareholders in APEC also conform largely to the important elements of good corporate governance, although many respondents did not make clear whether the rights of shareholders are in fact being exercised (e.g., adding items to the agenda for annual shareholder meetings).

One area that could be improved and strengthened is the composition and responsibilities of the board of directors, the company body responsible for establishing and overseeing good governance. In the United States and Korea, the boards of large listed companies are required to have a majority of independent directors. Other responding economies indicated requirements for as few as two independent directors and typically no more than one-third of the board.<sup>42</sup> The principle here is that boards must be capable of exercising objective and independent judgment. Ensuring objectivity often requires that a sufficient number of board members not be employed by the company or its affiliates and not be closely related to the company or its managers. The number or percentage of independent directors needed to achieve objectivity and independence will vary with the size and structure of the company and the board’s committee structure and workload. The specific number of independent directors, of course, is less important than the directors’ quality and integrity and ensuring that board members enjoy the respect and confidence of shareholders.

Only four economies report that independent directors are responsible for or have an explicit role in determining what information the board receives from management.

In Indonesia, the Philippines and Russia, board members are elected annually. In some economies board members may have a term of office as long as three years.

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<sup>40</sup> In Hong Kong China, most delistings applied to failed companies. New listings outpaced delistings by a ratio close to seven to one in 2009.

<sup>41</sup> A notable exception to this trend is an economy in which the number of listed companies grew steadily by about 30% per year from 2006 to 2009 and market capitalization quadrupled.

<sup>42</sup> A legal definition of “independence” was not requested for the IER, and unquestionably varies among economies

## CORPORATE GOVERNANCE RULES: DEVELOPMENT, ENFORCEMENT AND PRACTICE ASSESSMENT

### Development

There is considerable variation among APEC economies but, in general, capital market regulatory authorities and securities exchanges have taken the lead in developing corporate governance rules, sometimes by first establishing economy-wide advisory committees of public and private sector representatives to develop new rules for corporate governance.

In the 2002–2004 period, during which many reforms were undertaken worldwide, legislators seem to have exercised less initiative than securities commissions, integrated financial sector or capital markets regulators, other executive branch government entities, and stock exchanges. Various private organizations (directors associations, chambers of business and commerce, shareholder rights groups) have been developing corporate governance rules in recent years.

### Enforcement

In APEC economies with a common law tradition shareholder lawsuits are often relied on to compel compliance with corporate governance rules. In these economies, the financial regulators tend to enforce laws governing the issuance and trading of securities rather than enforce rules of corporate governance, for securities firms or otherwise. One exception is Hong Kong China, which has a common law tradition. The Stock Exchange of Hong Kong (SEHK) is the main regulator of listed companies' corporate governance.

In APEC economies with a civil law tradition, regulators and the stock exchanges in which they wield authority enforce rules for corporate governance. In some APEC economies institutional investors have become more involved in enforcement, often without recourse to regulatory authorities or lawsuits. For government-owned companies oversight bodies enforce corporate governance rules by means of directives issued to noncompliant companies.

One of the most common subjects of enforcement actions is failure to disclose material information or providing false or misleading information. Other actions pertain to tardy disclosure, failure to disclose related-party transactions, and directors' disqualifications. Other than failure to provide required disclosures, few stock exchange delistings were attributable to violations of governance rules. Questions about other disciplinary measures were not asked.

Relatively few enforcement actions were reported. Most economies reported fewer than a dozen actions in the past two years and only four reported more than 100. Several economies say that failure to enforce important shareholders' rights marks a major weakness in corporate governance.

Many companies follow important governance rules because they must otherwise explain noncompliance. Having to explain noncompliance, especially for matters easily complied with, seems to increase compliance with principle-based codes.

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#### Updating Company Law in China

The Standing Committee on Company Law Reform was established as a formal but nonstatutory body in 1984 to ensure that company law, including rules for corporate governance, keeps pace with the business environment. The Companies Registry acts as the secretariat and cooperates with the government in recommending amendments to the Company Ordinance. It launched a comprehensive rewrite of the Ordinance in mid-2006, which also covers amendments to the corporate governance rules.

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## Assessment of Practices

Before 2007, at least 11 APEC economies completed a report on the observance of standards and codes (ROSC) with respect to the OECD *Principles of Corporate Governance*.<sup>43</sup> Chile and Australia conducted self-assessments of compliance with the principles.<sup>44</sup> Russia has just started its self-assessment. And several economies report having implemented reforms based on ROSC assessments. In the Philippines, the stock exchange and the institute of directors both issue annual scorecards of compliance with good corporate governance practices. Since 2001, the Thai Institution of Directors' Association (IOD) has conducted corporate governance surveys of Thai listed companies, which are based on the Principles of Corporate Governance of the OECD. The objective of this survey is to provide an update of the governance practices employed by Thai firms.

## AWARENESS AND ADVOCACY

### Company Directors

More than half of APEC economies report having a directors' institute or association that promotes professional development through training in subjects of interest to directors and that provides a forum for exchanging ideas about the role of boards of directors. Viet Nam is planning to establish an institute of corporate governance in the near future. Mission statements and size vary, but some institutes provide training for hundreds and even thousands of directors. In some economies directors are required to undertake continuing education.

Some institutes have issued their own guidelines for directors and some issue certificates or designations that signify successful completion of training. Very few economies require director certification. Some institutes engage in advocacy in relation to proposals for new laws, regulations, or codes for corporate governance.

### Media

Most economies have developed programs to inform print and television journalists about the elements of good corporate governance. Such programs are sponsored by institutes of directors, stock exchanges, securities commissions and universities. In a few economies stock exchanges or securities commissions also provide background briefings for journalists on noteworthy developments.

All economies report that their financial media report news related to corporate governance, with some economies having more to report than others. In Canada, the *Globe and Mail*, an economy-wide newspaper, publishes *Board Games*, which evaluates and ranks corporate governance in Canada. In Singapore, the *Business Times* introduced its Corporate

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### Publications for Good Corporate Governance in Thailand

The Securities and Exchange Commission teamed with the Stock Exchange of Thailand and other institutions to publish guidelines and codes of best practice to aid good corporate governance. These include the Director's Handbook; Financial Advisor Due Diligence; Nomination Committee Guidelines; Remuneration Committee Guidelines; Corporate Governance Self Assessment; Best Practice of Shareholders; Code of Best Practice for Directors of Listed Companies; Audit Committee Checklist; Director Compensation Best Practices; Director Nomination Best Practices; Internal Control Checklist; and Q & A: Risk Management.

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<sup>43</sup> The ROSC assessments were typically part of the Financial Sector Assessment Programs undertaken between the host economy and the World Bank and the IMF.

<sup>44</sup> In an assessment of compliance with the OECD Principles of some 650 publicly traded companies in 2009, one economy concluded that two-thirds of the companies did not observe or materially did not observe the Principles.

Transparency Index in conjunction with the National University of Singapore Corporate and Financial Reporting Centre to gauge the transparency of Singapore-listed companies. The *Business Times* also sponsors the annual Singapore Corporate Awards to recognize excellence in shareholder communication and corporate governance. The Stock Exchange of Thailand periodically has a column in the *Post Today* newspaper, Enhancing Business with Corporate Governance.

## Educational System

Nearly every APEC economy reports that corporate governance is an integral part of its tertiary curriculum for business and legal studies. A few report that corporate governance is also covered at the undergraduate level.

## Stock Exchange

Stock exchanges in APEC economies have been prominent supporters of high standards of corporate governance as well as institutional supervisors of compliance. They have also been proactive in developing the understanding and skills required for corporate governance to be more effective. Stock exchanges in APEC economies have offered or supported director training programs as well as general programs in retail and institutional investor education that cover corporate governance. The stock exchange in Canada offers to assist companies in identifying qualified directors to serve on their boards.

## CORPORATE GOVERNANCE OF STATE-OWNED AND FAMILY-CONTROLLED ENTERPRISES

### State-owned Enterprises

According to the IERs, authority-owned or controlled enterprises in APEC economies are governed by centralized oversight bodies in the ministry of finance or economic affairs, or by other sector- or ministry-level bodies. In Peru, Singapore and Russia an investment company owns such enterprises and is operationally separate from any ministry. Whether such enterprises are subject to the same corporate governance requirements as privately owned enterprises varies across APEC economies. Some have special regimes, but it is common for listed companies to be subject to listing requirements regardless of ownership.

For many years authority-owned or controlled enterprises in Russia had governing bodies composed essentially of government officials, some appointed by different ministries. The current trend is for such enterprises to have independent directors and board members who are not civil servants and are designated to represent the government in accordance with mandates on certain subjects.

### Family-controlled Enterprises

At least eight APEC economies have high concentrations of large family-owned companies, and Indonesia reports that approximately 10 families control the majority of listed companies. APEC economies with a high concentration of such companies reported many issues

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#### Board Members for State Enterprises in Thailand

The State Enterprise Policy Office introduced the Directors Pool in 2008 to ensure the appointment of appropriate board members to authority-owned or controlled enterprises. The pool consists of specialists whose knowledge, skills and expertise comply with the principles and procedures approved by the cabinet. In this regard, the General Qualifications of Members and Officials of State Enterprise Act, B.E. 2518 (1975) as amended in 2007 stipulates that at least one-third of board members of authority-owned or controlled enterprises who are not ex officio in any state enterprise shall be selected from the pool.

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related to corporate governance,

including nonprofessional directors on boards, lack of independence of nominally independent directors, and lax practices for disclosure, approval, and fairness evaluations of related-party transactions. In some economies, competitive pressures compel these companies to be governed like companies not controlled by families. In Canada, family control is maintained by having classes of shares with different voting rights, with family-owned shares having voting control. Korea reports that family-owned companies are in the forefront of advancing corporate governance and the rights of shareholders with relatively small ownership interests.

Most economies report that corporate governance requirements do not discourage family-owned companies from becoming listed companies. Two economies report that such requirements are a disincentive to listing, with New Zealand citing specifically the requirement for nonexecutive directors and the costs of compliance as deterrents.

## **PROFESSIONAL SERVICE PROVIDERS AND CORPORATE GOVERNANCE**

The IERs received suggest that professional service providers have been involved in or supportive of recent developments in corporate governance. The notable exception is Viet Nam, where professional service providers other than auditing firms have not played a role in corporate governance counseling thus far.

### **Accounting and Auditing Firms**

Accounting and audit firms have been advising boards and helping revise practices and formats to comply with IFRS. Only a few economies have started having audit firms provide an opinion on the quality of a company's internal audit and controls to the board or board audit committees.

### **Security Analysts, Banks, Rating Agencies**

Professionals from security rating agencies, security analysts and banks have closely followed or been involved in corporate governance as it affects investor appeal, creditworthiness, disclosure requirements, compliance determination and other concerns. They have advised director institutes, trading exchanges, regulatory agencies, or task force committees formed to develop guidelines on good governance.

### **Law Firms and Corporate Governance Specialists**

Law firms have become increasingly involved in helping listed companies comply with corporate governance requirements—by preparing or reviewing documents that must be filed with regulatory authorities supervising compliance with rules and statements made in annual reports and disclosure documents or other company documents regarding governance practices. Some economies report increasing use of specialists in corporate governance compliance, especially with regard to executive compensation and independent director requirements.

## RECENT DEVELOPMENTS

### Corporate Governance

A number of economies reported significant developments in corporate governance policies and practices in the past year. These include changes in legislation, in stock exchange listing requirements and regulatory actions, and voluntarily adopted company practices.<sup>45</sup>

**Legislation.** New legislation affecting corporate governance practices has been recently passed, is underway, or is under consideration in at least 13 APEC economies.

**Governance Codes.** Malaysia recommended that the audit committee of the board be composed wholly of independent directors. In Thailand, it is mandatory that the audit committee of the listed companies must be composed wholly of independent directors. Some other APEC economies, including Canada and Indonesia, report increased attention to company policies regarding corporate social responsibility.

### Enforcement

The IERs reflect wide variance in the enforcement of corporate governance rules.

**Transparency.** More than eight economies, including Mexico, Peru, Singapore and the United States, report sanctions for violations of listing and financial disclosure requirements. Malaysia's securities commission has established an audit oversight board to improve the quality of audit reports of listed companies.

**Shareholder Rights.** Only the United States saw a significant number of reports of shareholder actions. At least several hundred lawsuits alleging violation of shareholders' rights are brought each year in the United States, and many of these are resolved by settlement or otherwise and do not result in a court decision.

**Board Responsibilities.** Several economies report breaches of fiduciary duties of due care and diligence by directors and officers of companies. In Chile, the regulator fined a company's CEO for concealing material information and fined directors for not exercising their duty to be fully informed. In 2009, the Thai SEC filed 12 complaints with the criminal authorities alleging 51 persons for violating securities or derivatives laws. Two major cases involved the act of fraud and embezzlement of assets of the publicly traded companies by their executives, accounting for the estimated damages of 1,998 million baht in total.

### Challenges for Corporate Governance and Priorities for Reform

Broadly speaking, APEC economies are strengthening corporate governance by (1) protecting shareholders' rights, (2) making boards of directors more effective, and (3) improving the enforcement of corporate governance rules. Table 3-1 summarizes the most common priorities in these three areas.

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<sup>45</sup> "Following submission of its IER, two notable developments occurred in the arena of Corporate Governance in the United States. First, on August 25th, 2010, the SEC approved a final "proxy access" rule that will make it easier for large long-term shareholders in public companies to nominate corporate board members. Also in July, the US Congress passed the Dodd-Frank Act, which institutes significant reforms, including requiring additional compensation disclosure, 'say on pay' votes and independent compensation committees for publicly traded companies."

Table 3-1  
*Most Common Priorities for Reform*

Shareholders' Rights	Boards of Directors	Enforcement
Raising awareness and understanding of shareholder rights and responsibilities to encourage shareholder engagement	Increasing the knowledge and professionalism of board members	Augmenting the capacity of regulatory agencies
Protecting the interests of minority shareholders	Expanding the pool of qualified independent directors	Increasing effectiveness of civil sanctions
Reducing the cost of protecting shareholders' rights, including facilitating class action lawsuits	Reforming board oversight of executive compensation policies and practices	Improving transparency and disclosure
Using of modern communication technologies to facilitate disclosure, voting, and other shareholder participation	Enhancing the effectiveness of board committees on strategic issues, including for risk management	Improving oversight and enforcement of securities exchange listing rules
Addressing conflicts among stakeholder groups	Separating the roles of chief executive officer and chairman of the board	Strengthening regulation of auditors

For instance, in the United States last year, the Delaware General Corporation Law<sup>46</sup> was amended to clarify the power of stockholders to adopt bylaws that (1) require the company to include stockholder nominees for election as directors in the company's proxy solicitation materials, or (2) require the company to reimburse a stockholder for costs of soliciting proxies on behalf of one or more nominees for election as director. Similar amendments were made to the Model Business Corporation Act, which serves as a model for corporate statutes in approximately 30 other US states.

In Thailand, since 2006, the SEC, in cooperation with the TIA and the Thai Listed Companies Association (TLCA), conducted an assessment of the Annual General Meeting (AGM) to increase awareness of listed companies about the importance of AGM and to encourage shareholders' active participation. The SEC also provided an AGM checklist as a best practice guideline for listed companies. One assessment of the checklist is that the company provides an opportunity for shareholders to propose additional agenda items and nominate qualified directors before the AGM notice. The result of the 2010 AGM assessment project stated that 61% of listed company complied with this recommendation (an increase from 51% in 2009).

### ***Response to Global Financial Crisis***

The global financial crisis of 2008–2009 originated in the United States and affected many other economies. APEC economies were less affected because their leading financial institutions had not invested or traded heavily in mortgage-backed securities and were not exposed to the risks carried by financial institutions involved with these and related financial products. Still, many economies suffered the secondary effects of the credit contraction and the subsequent economic contraction.

APEC economies reporting on the impact of the crisis on corporate governance structures tend to cite one or more of three areas as targets of reform: corporate risk management, executive compensation and oversight by boards of directors. There is special concern about misalignment of compensation practices and excessive risk taking in financial institutions.

Table 3-2 summarizes the responses by member economies to the Appendix portion of the IERs. Numbers in columns indicate how many member economies responded a particular way. Full IERs follow the table.

<sup>46</sup> This law is applicable to most Fortune 1000 companies in the United States.

Table 3-2  
*Summary of Key Corporate Governance Rules and Practices in APEC*

Element	Yes	No	NC <sup>a</sup>	Source <sup>b</sup>	Comments
<b>RIGHTS OF SHAREHOLDERS</b>					
1. Do shareholders add items to the agenda for shareholders' meetings?	15	1	2	CL, SL, SLR	Not common in practice; typically for shareholders owning 10% of equity
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	17		1	GP, CL, CGC	This is a common practice but nowhere are answers required by law or regulation
3. Must company transactions with its insiders be on a nonpreferential basis?	10	2	6	CL, SL, SLR, CGC	Approval by shareholders or disclosure is not the same as fairness
4. Is a super majority vote required for major company acts affecting shareholders' rights?	14	2	2	CL, SLR	Supermajority generally requires 75% in APEC economies
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>					
5. Must boards have independent directors? What percentage?	11	4	3	CGC, CL, SLR SL	Typically a recommendation, or if required, one-third; non-executive director is not <i>per se</i> independent
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?	7	5	6	CL, SL, CGC, SLR, GP	When audit committees must have majority of independent directors, (a) is yes and (b) is usually "no." Both (a) and (b) are typically a code recommendation.
7. Do independent directors decide what information the board receives from management?	2	10	6	CGC, CL	Should be the case if chairman of board is independent
8. Are the chairman of the board and chief executive officer different persons in the majority of listed companies?	10	4	4	CGC, CL, GP	Typically this is recommended in a code, or is a common practice, but not required
9. Are all board members elected annually?	3	14	1	CL, GP, CGC	Board members are usually elected for more than one year
10. Does the board oversee enforcement of a company code of conduct?	8	4	6	GP, CL, CGC, SLR	Some answers confounded code of conduct (ethics) with corporate governance code
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>					
11. Do financial statements comply with IFRS?	9	4	5	SL, SLR	In only a few economies is this now required; some require in 2011-13
12. Are the identities of the five largest shareholders disclosed?	16	1	1	SL, CL SLR	Disclosure of beneficial ownership of nominee and holding companies is an issue
13. Is compensation of company executive officers disclosed?	14	3	1	SL, SLR CGC, CL	
14. Are extraordinary corporate events disclosed?	17		1	SL, SLR CL, CGC	Promptly in some economies; in others as late as in the annual report
15. Are risk factors disclosed in securities offering materials?	18			SL, SLR	
16. Are transactions of a company with its insiders disclosed?	15	1	2	SL, CL SLR	Timing of disclosure varies; if the identity of beneficial owners is not disclosed, transactions with insiders cannot be known

NC=Not Clear. For example, the comments indicate that a practice is desirable or required but not that it is typically observed. Source abbreviations: CL= company law, SL= securities law or regulations, CGC=corporate governance code, SLR= stock exchange listing requirement, GP=general practice but not obligatory.

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# Annex

<b>Australia .....</b>	<b>51</b>
<b>Canada .....</b>	<b>59</b>
<b>Chile .....</b>	<b>71</b>
<b>Hong Kong, China .....</b>	<b>81</b>
<b>Indonesia.....</b>	<b>101</b>
<b>Japan.....</b>	<b>113</b>
<b>Korea.....</b>	<b>121</b>
<b>Malaysia.....</b>	<b>129</b>
<b>Mexico.....</b>	<b>151</b>
<b>New Zealand.....</b>	<b>161</b>
<b>Peru .....</b>	<b>169</b>
<b>Philippines .....</b>	<b>175</b>
<b>Russian Federation .....</b>	<b>185</b>
<b>Singapore .....</b>	<b>199</b>
<b>Chinese Taipei.....</b>	<b>207</b>
<b>Thailand.....</b>	<b>215</b>
<b>United States.....</b>	<b>225</b>
<b>Viet Nam.....</b>	<b>237</b>

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# Australia

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in Australia

#### 1.1 Background

The basic rights of shareholders and duties of directors are contained both in the *Corporations Act 2001* (Corporations Act) and in the common law. Before the enactment of this legislation there was an economy-level code system and prior to that a state-based system. Financial and non-financial reporting requirements are contained in the Corporations Act, in accounting standards and in the Australian Securities Exchange (ASX) Listing Rules.

The Australian Securities and Investments Commission (ASIC) is an independent statutory authority tasked with enforcing compliance with these laws. As corporate regulator, ASIC also sets standards, issues best practice guidelines and, together with the ASX, has a key role in delivering information to the market. The Australian Prudential Regulation Authority (APRA) maintains prudential standards concerning corporate governance arrangements for authorised deposit-taking institutions and risk management standards for general insurers.

The ASX, the largest financial market in Australia, acts as co-regulator in respect of a range of market issues. This occurs primarily through enforcement of the ASX Listing Rules, which deal with such matters as audit committees, continuous disclosure obligations, reporting requirements and rules affecting dealings in listing securities. However, the recent government decision to transfer responsibility for real-time supervision of trading activity on Australia's domestically licensed markets to ASIC will impact on ASX's role in respect of listings, particularly in respect of detection of events like insider trading.

Voluntary industry codes of corporate governance are also common.

#### 1.2 Trends

The number of publicly traded companies listed on the ASX has increased over the past five years, from 1,774 in 2005 to 2,198 in 2009. Between 2006 and 2008, the number of new listings was steady, with 222 listings in 2005, 227 in 2006, 284 in 2007 and 236 in 2008. The number of new listings declined sharply in 2009 to 45, due to volatility arising out of the Global Financial Crisis (GFC).

In 2005, total market capitalisation was A\$960 billion. Between 2006 and 2007, market capitalisation rose from A\$1.2 trillion to A\$1.5 trillion. From 2008, market capitalisation fell to A\$1.4 trillion, crashing to A\$1.098 trillion in 2009. Again, the volatility associated with the GFC was the reason.

### **1.3 Key Corporate Governance Rules and Practices**

Please see Key Corporate Governance Rules and Practices in Australia, p. 57.

## **2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules**

### **2.1 Development of Corporate Governance Rules**

The Treasury has portfolio responsibility for the development of corporate governance policy, including any changes to the legislative structure. Under the Australia Constitution, the Governor-General is responsible for making regulations, on the advice of the relevant Minister.

In some circumstances, ASIC has discretion (both specific and general) to exempt persons or classes of persons from compliance with the law. ASIC is also active in issuing regulatory guides, which, while not legally binding, provide important guidance as to how ASIC will exercise its powers.

The ASX makes and administers operating rules for listed companies. The ASX Council publishes the *Corporate Governance Principles and Recommendations* which provide for specific corporate governance requirements. For listed entities, the principles must be reported against in annual reports on an 'If not, why not' basis.

### **2.2 Enforcement of Corporate Governance Rules**

Corporate governance rules can either be enforced through Corporations Act-based legal action or through market-based actions. ASIC can choose to take an enforcement action for breaches of the Corporations Act. A summary of recent ASIC actions is provided below in section 6.2.

In financial years 2008/2009 and 2009/2010 to date, ASIC commenced eight actions against corporations and directors alleging breach of directors' duties and dishonest conduct. One action was commenced in relation to continuous disclosure. In 2008/2009 ASIC also disqualified 49 people from managing corporations for periods of up to five years. Without needing to take enforcement action, ASIC also had various corporate documents, including notices of meeting, amended to improve the disclosure of information to shareholders.

Companies must report each year against the *ASX Corporate Governance Principles Recommendations*. Under ASX listing rule 17.12, the ASX may remove a company from the official list if, in the ASX's opinion, the entity breaks a listing rule. Since July 2008, there have been three companies delisted at ASX's discretion under listing rule 17.12. The bulk of delistings take place following a corporate transaction, at an entity's own request or for failing to pay annual listing fees (mainly due to ceasing to operate).

### **2.3 Assessment of Corporate Governance Practices**

Australia undertook a self-assessment in 1999 based on a prototype Report on the Observance of Standards and Codes (ROSC), although this pre-dated the current assessment framework (introduced in 2001). The International Monetary Fund (IMF) undertook an informal assessment on selected issues in the corporate governance framework as part of the Financial Sector Assessment Program process in 2005-06.

## **3. Awareness and Advocacy for Good Corporate Governance**

### **3.1 Company Directors**

The Australian Institute of Company Directors (AICD), the largest representative organisation for directors, provides links to information, educational activities, corporate governance guidance for directors and lobbying and advocacy roles. Guidance on good corporate governance is also provided by a range of industry associations. Much of the guidance provided by these bodies is publicly available and in many cases free of charge. While director training is not compulsory, a number of private sector organisations (for example, the AICD and the Chartered Secretaries of Australia) do run such programs, and continuing education for directors is strongly encouraged by the regulator and private organisations.

### **3.2 Media**

The financial press often reports on issues of corporate governance and legislative and private sector reforms in this area. However, there are no educational programs which focus specifically on corporate governance awareness for journalists. Topics which have received recent coverage include executive remuneration and the ASX's recently announced initiative to improve the number of women on boards.

### **3.3 Educational System**

Although mainly found in the Law, Commerce and Accounting areas, a number of undergraduate and postgraduate tertiary programs offer corporate governance components. The teaching of corporate governance is also a component of many of Australia's MBA courses.

### **3.4 Stock Exchange**

The ASX does not provide compulsory training for company directors. The educational programs provided by the ASX are focused foremost on retail and institutional investors. As mentioned above, the ASX is responsible for the *Corporate Governance Principles and Recommendations* and other publications promoting good corporate governance.

## **4. Corporate Governance of State-Owned and Family-Controlled Enterprises**

### **4.1 State-Owned Enterprises**

At the Commonwealth level, state-owned enterprises (SOEs) are governed by the *Commonwealth Authorities and Companies Act 1997* (the CAC Act). The CAC Act sets out the financial management, accountability and audit obligations of Commonwealth statutory authorities and companies the Commonwealth controls. In particular, the CAC Act provides: the reporting and audit obligations for Commonwealth authorities; standards of conduct for officers of authorities; and requirements for ensuring that Commonwealth authorities and wholly-owned Commonwealth companies keep Ministers and Parliament informed of their activities.

The CAC Act requires reporting in addition to the enabling legislation or company constitution. For example, the CAC Act bodies must give annual, operations and auditor reports to the relevant Minister; must inform the Minister of significant events, for example the acquisition or disposal of significant property; and, for Government Business Enterprises, must provide a corporate plan at least annually.

The Commonwealth's corporate governance framework is designed to increase levels of accountability and transparency across all Commonwealth companies and authorities.

## 4.2 Family-Controlled Enterprises

There are no specific corporate governance problems regarding family-controlled enterprises in Australia. Australia's listing rules do not discourage family-controlled enterprises from becoming publicly listed for reasons of corporate governance. The majority of Australia's corporate governance obligations are imposed on all companies, whether privately held or publicly listed, through the Corporations Act. The *ASX Corporate Governance Principles and Recommendations* are not mandatory, and compliance is only required to be disclosed on an 'if not, why not' basis.

## 5. Role of Professional Service Providers in Corporate Governance

Professional service providers play a significant role in the dissemination of corporate governance information. Ratings agencies and some analysts make public their findings, however accounting, auditing and legal firms may be employed on an internal basis and therefore their work will only be made public with the approval of the employing entity. Law firms, auditors and accountants are usually employed to provide either a financial audit or a systems audit, which often include a corporate governance component. In addition, the use of proxy advisers and remuneration consultants is becoming more common.

## 6. Recent Developments in Corporate Governance

The *Corporations Amendment (No. 1) Act 2009* provides that a person is disqualified from managing corporations in Australia if the person has been disqualified from acting as a director of a foreign company by a foreign court. Currently, the regulations only recognise Court orders made in New Zealand.

The *Corporations Amendment (Improving Accountability on Termination Payments) Act 2009* strengthens the regulatory framework relating to the payment of termination benefits to company directors and executives. The Act restricts termination benefits by: reducing the threshold for shareholder approval from seven times total annual remuneration to one year's average base salary (noting that base salary is commonly only a small proportion of total remuneration); ensuring that termination benefits that exceed the threshold will require approval, regardless of whether they are made to directors or executives; and expanding the definition of termination benefits to cover all payments made at termination that are not bona fide entitlements.

The *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007* received royal assent on 28 June 2007. Prior to this amendment, the Corporations Act provided that shareholder approval was not needed for a transaction involving giving a benefit to a director or spouse where the benefit did not exceed A\$2,000. The amended section now: (a) applies to any related party (not just a director or spouse); and (b) provides that member approval is not required where the amount or value of the financial benefit is less than or equal to the amount prescribed by the regulations—currently A\$5,000.

The *ASX Corporate Governance Principles and Recommendations* that provide guidance to companies in implementing good corporate governance are currently being revised. The ASX is consulting on a recommendation requiring boards to implement board diversity goals, particularly in reference to gender, and then to report against them in their annual report. It is expected to be instituted from 1 January 2011.

## 6.1 Corporate Governance Developments

During 2008-09, 72 corporate takeovers and mergers were announced in Australia, down from 109 in 2007-08. One quarter of the deals required government approval of a foreign investment. All of the seven transactions with values over A\$1 billion involved foreign parties. The Takeovers Panel was involved in 20% of transactions. More than two-thirds of transactions involved takeovers, with the average delay for a scheme of arrangement compared with a takeover being one month.

In 2009, the Productivity Commission (PC), at the request of the Australian government, conducted a broad-ranging inquiry into the regulation of executive remuneration. The PC reported on 4 January 2010. The government supports the majority of the PC's recommendations, including the "two strikes" proposal, which will strengthen the non-binding shareholder vote on remuneration and sets out consequences where companies do not adequately respond to shareholder concerns on remuneration issues. The proposed changes will also, amongst other things: require a board to obtain shareholder approval before declaring that there is "no vacancy" on a company's board; reduce conflicts of interest by preventing key management personnel from hedging the incentive components of their remuneration or voting on their own remuneration arrangements; and require proxy holders to vote all directed proxies as designated. Legislation giving effect to the reforms will be introduced this year, following public consultation. The proposed changes follow reforms to Australia's system of termination benefits passed in 2009 (see Section 6 above).

The Australian government has provided funding to the St. James Ethics Centre over the past three years to assist in the Centre's efforts to expand the number of Australian companies that are actively engaged in identifying and adopting more responsible business practices. An Australian Global Compact Focal Point and an Australian Global Reporting Initiative Focal Point are now established in Australia. In February 2009, the Australian government also agreed to provide funding to the Responsible Investment Association of Australasia (RIAA) to assist it in its efforts to create a centre for responsible investment education and training.

## 6.2 Enforcement of Corporate Governance Rules

In 2009, ASIC unsuccessfully took action against Fortescue Metals Group and its Chief Executive Officer alleging breaches of the corporate governance law as a result of announcements to the ASX in 2004. This case raised important issues as to the proper interpretation and application of provisions of the Corporations Act that govern company announcements such as the misleading and deceptive conduct provisions, the continuous disclosure provisions and directors' duties. ASIC has announced its intention to appeal.

In January 2010, ASIC launched criminal proceedings against three former directors of Opes Prime, each of whom was charged with breaching their duties under the Corporations Act. ASIC alleges that the directors signed documents agreeing to a loan with ANZ bank shortly before Opes Prime collapsed, pledging the company's assets as security to meet the obligations of a third party. As a result, ASIC alleges that the directors were intentionally dishonest in signing this contract and failed to discharge their duties in the best interests of the company; and that the directors dishonestly used their positions to directly or indirectly gain a personal advantage. A committal mention will be held in late May 2010.

In April 2009, the former non-executive directors and executives and James Hardie Industries were found to have breached the Corporations Act when making statements about the adequacy of asbestos compensation funding. James Hardie Industries NV was also found to have breached

its continuous disclosure obligation in 2003. In August 2009, the New South Wales Supreme Court imposed pecuniary penalties and disqualification orders against the company officers.

ASIC commenced civil penalty proceedings in 2007 against the former chief executive of the Australian Wheat Board (AWB) and five other former AWB directors and officers, alleging they had breached their fiduciary duties under the Corporations Act concerning AWB's involvement in the UN Oil-For-Food Programme. ASIC alleges that the defendants contravened sections of the Corporations Act which require company officers to act with care and diligence, and which require company officers to discharge their duties in good faith and for a proper purpose. ASIC is seeking declarations that each defendant has breached the law, the imposition of pecuniary penalties and disqualification of each defendant from managing a corporation.

### **6.3 Current Issues and Challenges for Corporate Governance**

#### **6.3.1 Challenges**

A question remains as to how to deal with the interests of multi-stakeholder corporations. For example, should the ultimate aim of the board be to maximise and distribute shareholder profits or to safeguard assets for the benefit of creditors. In addition, how important should the role of the community be in understanding and organising stakeholder priority. Another challenge facing Australia's corporate governance system is whether shareholders participate to a sufficient level to assist good corporate governance practices. The inclusion of an engaged shareholder group will encourage good corporate governance and hold directors to a high standard.

#### **6.3.2 Priorities for Reform**

Priorities for reform include the implementation of the new supervisory role for ASIC over Australia's domestically licensed financial markets. Legislation was passed in early 2010 to give effect to this change. Draft regulations are currently out for consultation. The transfer of supervisory responsibility to ASIC is expected by the end of 2010.

As noted above, the Australian government intends to introduce legislation in 2010 to address issues identified in Australia's remuneration framework. In particular, the reforms will improve board capacities; reduce conflicts of interest; encourage stakeholder engagement; and improve relevant disclosure.

#### **6.3.3 Financial Crisis**

Australia's corporate governance framework stood up well during the GFC, and as such wholesale changes to the framework are not considered necessary.

The Federal government introduced new legislative requirements to regulate the use of short selling in Australia. The requirements included a ban on naked short selling, subject to some minor exceptions, and the imposition of specific reporting obligations in relation to covered short sales. In September 2008, ASIC also took emergency action to temporarily ban short selling in Australia, including naked short sales and covered short sales. The ban on covered short selling of non-financial securities was lifted on 19 November 2008, while the ban on covered short selling of financial securities was lifted on 25 May 2009.

The GFC also highlighted the importance of ensuring that remuneration packages are appropriately structured and do not reward excessive risk taking or promote corporate greed. Australia has taken action to address those concerns (see Section 6).

## Key Corporate Governance Rules and Practices in Australia

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for meetings?	X		CL	
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		CL	
3. Must company transactions with its insiders be on a non-preferential basis?		X		There are a number of rules relating to when a related party transaction can be approved, including shareholder approval, but there is no requirement that the transactions be on a non-preferential basis.
4. Is a super majority vote required for major company acts affecting shareholder rights?	X		CL	If there is no provision in the company constitution then at least 75% of the members of the class whose shares are being altered need to agree to the change. However, the company constitution may outline a different procedure.
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors? What percentage?		X		SLR: A board is not required to have a certain percentage of independent directors, however the ASX Principles suggest that a majority of directors are independent. As described above these principles require listed entities to report on an <i>If not, why not</i> basis.
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?	X		GP	A number of listed entities have independent remuneration committees which oversee these issues. Whilst this is not mandatory and is not undertaken by all companies it is a feature of general practice. Under the Listing Rules, ASX 300 companies must have an audit committee which is comprised of a majority of independent directors.
7. Do independent directors decide what information the board receives from management?		X		
8. Are the chairman of the board and chief executive officer different persons in the majority of listed companies?	X		GP	
9. Are all board members elected annually?		X		
10. Does the board oversee enforcement of a company code of conduct?			GP	A director appointed between annual general meetings (AGMs), to fill a vacancy, must stand for election at the next AGM. All directors of listed companies (excluding the managing director) must stand for re-election every three years.
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with International Financial Reporting Standards (IFRS)?	X			Australian Accounting Standards Board requirement.
12. Are the identities of the five largest shareholders disclosed?	X		SLR	Under Listing Rule 4.10 a listed entity needs to provide the names of the 20 largest holders of each class of shares and the number and percentage of capital held by each of them.

Element	Yes	No	Source(s) of Rule	Comments
13. Is compensation of company executive officers disclosed?	X		CL	The Corporations Act provides for particular executive remuneration reporting in annual reports. As outlined above this process is currently under review.
14. Are extraordinary corporate events disclosed?	X		CL	The annual report must give details of any significant changes in the entity's state of affairs during the year, including any significant changes in the nature of the entity's activities. In addition listed companies are subject to continuous disclosure requirements relating to certain significant events.
15. Are risk factors disclosed in securities offering materials?	X			There are a number of different requirements for disclosure statements, including forecasting risk factors.
16. Are transactions of a company with its insiders disclosed?		X		These types of transactions must be disclosed as part of the entity's financial statements in compliance with the accounting standards. They will often be disclosed in other ways, for example through the requirement that shareholders vote on the related party transaction.

*Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory*

# Canada

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in Canada

#### 1.1 Background—Legal and institutional basis of the corporate governance framework

*i) Corporate Law:* For-profit Canadian companies may choose to incorporate either under the federal *Canada Business Corporations Act* or one of the similar provincial-territorial corporate statutes.<sup>47</sup> There are a variety of other statutes that impose duties on corporate directors such as federal insolvency laws, federal and provincial environment laws and provincial employment standard laws. Federal statutes governing certain sectors like banking, insurance and telecommunications impose further obligations.

*ii) Securities Law:* Publicly-traded companies (i.e., issuers of equities) are also governed by securities regulation, which is the responsibility of provincial-territorial governments, each having its own legislation and securities regulation authority. All of the provincial-territorial securities regulation authorities coordinate policy development and enforcement through a voluntary umbrella organization—the Canadian Securities Administrators (CSA)—with a view of developing a harmonized approach to securities regulation across the economy through the use of economy-wide policies and instruments.<sup>48</sup> In recent years, the CSA has developed a “passport system” through which a market participant has access to markets in all passport jurisdictions—all provinces and territories except Ontario—by dealing with its principal regulator and complying with one set of harmonized laws.

*iii) Stock Exchange Listing Requirements:* Canada’s senior issuers are listed on the Toronto Stock Exchange (TSX) and Canada’s junior issuers on the TSX Venture Exchange (TSXV).

To list on the TSX, a company must submit a listing application and supporting documents such as a Personal Information Form. Resource companies must also submit geological reports in compliance with regulatory guidelines, as prepared by an independent, qualified third party. The TSX Listing Committee is responsible for approving applicants. Successful applicants are charged a listing fee.

To list on the TSXV, a company’s application must be sponsored by a TSXV member, which has expertise in the public venture capital marketplace. To negotiate the complex listing process, the company requires the following professional advisors: a securities lawyer; an

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<sup>47</sup> Not-for-profit corporations are governed by the federal *Canada Corporations Act* and provincial-territorial not-for-profit statutes.

<sup>48</sup> See CSA website at <http://www.securities-administrators.ca/>

investor relations professional; and an external auditor. The company must file a prospectus and establish a business plan. Successful applicants are charged a listing fee.

*iv) Corporate Governance Guidelines:* The CSA employs a principles-based approach to corporate governance through the implementation of National Policy 58-201 and National Instrument 58-101, both introduced in 2005 in response to (a) the Saucier Report of 2001, which reviewed the state of corporate governance in Canada, and (b) the *Sarbanes-Oxley Act* (2002) in the United States. NP 58-201 is a set of Corporate Governance Guidelines, which issuers are encouraged to consider in developing their own corporate governance practices.<sup>49</sup> While compliance with the Guidelines is voluntary, NI 58-101—Disclosure of Corporate Governance Practices—imposes mandatory disclosure by issuers of their corporate governance practices, with a requirement that they disclose, through an annual information circular, whether their corporate governance practices adhere to or depart from those practices recommended in the Guidelines.<sup>50</sup> Additionally, the Canadian Coalition for Good Governance, a not-for-profit corporation founded in 2003 to represent the interests of institutional investors, has as its mission to promote good governance practices in Canadian public companies and, in this regard, has developed corporate governance guidelines entitled “Building High Performance Boards” that its members expect Canadian companies to develop and adopt over time.<sup>51</sup>

## 1.2 Trends—Number of publicly traded companies in Canada and their market capitalization over the past five years

The number of issuers and their market capitalization for the TSX and TSXV over the past five years is shown in Table 1.

Table 1. Number of Issuers and Market Capitalization, TSX and TSXV, 2005-2009

	<u>TSX</u>	<u>TSXV</u>	<u>Total</u>
<b>NUMBER OF ISSUERS</b> <sup>52</sup>			
2005	1,537	2,221	3,758
2006	1,598	2,244	3,842
2007	1,613	2,338	3,951
2008	1,570	2,443	4,013
2009	1,462	2,375	3,837
<b>MARKET CAPITALIZATION (C\$ BILLIONS)</b> <sup>53</sup>			

<sup>49</sup> NP 58-201 may be viewed at [http://www.osc.gov.on.ca/en/SecuritiesLaw\\_rule\\_20050617\\_58-201\\_corp-gov-guidelines.jsp](http://www.osc.gov.on.ca/en/SecuritiesLaw_rule_20050617_58-201_corp-gov-guidelines.jsp) CSA’s Corporate Governance Guidelines replaced the TSX’s “best practice guidelines”, which were introduced in 1995, following the recommendations of the Dey Report in 1994. While the Guidelines also apply to TSXV-listed issuers, the substantive corporate governance requirements set out in the TSXV Corporate Finance Manual continue to apply.

<sup>50</sup> NI 58-101 may be viewed at [http://www.osc.gov.on.ca/en/SecuritiesLaw\\_rule\\_20050617\\_58-101\\_disc-corp-gov-pract.jsp](http://www.osc.gov.on.ca/en/SecuritiesLaw_rule_20050617_58-101_disc-corp-gov-pract.jsp)

<sup>51</sup> See [http://www.ccg.ca/index.cfm?pagePath=CCGG\\_Policies\\_Best\\_Practices/Guidelines\\_Principles/Corporate\\_Governance&id=17595](http://www.ccg.ca/index.cfm?pagePath=CCGG_Policies_Best_Practices/Guidelines_Principles/Corporate_Governance&id=17595)

<sup>52</sup> Source: *Toronto Stock Exchange Yearly Trading Summary* and *TSX Venture Exchange Yearly Trading Summary*, at [http://www.tmx.com/en/news\\_events/media\\_kit/](http://www.tmx.com/en/news_events/media_kit/)

	<u>TSX</u>	<u>TSXV</u>	<u>Total</u>
2005	1,831	34	1,865
2006	2,061	55	2,117
2007	2,093	58	2,152
2008	1,279	17	1,296
2009	1,772	36	1,808

### 1.3 Key Corporate Governance Rules and Practices

Please see Key Corporate Governance Rules and Practices in Canada, p. 69.

## 2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules

### 2.1 Development of Corporate Governance Rules

In respect of corporate law, at the federal level, Corporations Canada, a branch within the federal Department of Industry, is responsible for corporate laws governing federal companies, except financial intermediaries. Provincial-territorial governments develop their own corporate governance rules.

Regarding securities law and stock exchange listing requirements, these are developed by provincial-territorial securities regulation authorities and their umbrella group, the CSA.

As for corporate governance guidelines, these are developed by the CSA, the private sector Canadian Coalition for Good Governance, and individual companies themselves.

### 2.2 Enforcement of Corporate Governance Rules

Canadian corporate law is mostly self-enforced by the corporation's shareholders, who will vote on resolutions and file them with their company, with the purpose of having them adopt certain corporate governance practices. These tend to relate to board of director independence (ensuring the chairman of the board and CEO positions are kept separate), director attendance at board and committee meetings, and executive compensation. In 2008 and 2009, 178 and 101 shareholder resolutions were filed with corporations in Canada, respectively.<sup>54</sup> Shareholders whose rights have been denied can seek resolution through the courts.

Canadian securities law enforcement is carried out by provincial-territorial regulatory authorities, who investigate suspected securities-related misconduct and may bring allegations of such misconduct to a hearing before a securities commission or an associated tribunal. Securities legislation authorizes that they may impose or seek administrative sanctions and prohibitions from market participation or access. They have no authority to order a term of imprisonment but they can establish "quasi-criminal" offences for contraventions of regulatory requirements and prohibitions of certain activities related to capital markets. Penalties for committing these types of offences can include a term of imprisonment and a significant fine. Depending on the jurisdiction, staff may either directly prosecute such cases in court or refer allegations of "quasi-criminal" offenses to a Crown attorney for prosecution in the courts.

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<sup>53</sup> *Idem.*

<sup>54</sup> Source: the Shareholder Association for Research and Education's (SHARE) database at <http://www.share.ca/fr/shareholderdb>

Securities-related offences under the federal *Criminal Code*, which establishes both specific securities-related criminal offences (such as market manipulation) and more general economic crimes (such as fraud), are investigated by the Royal Canadian Mounted Police and local and provincial police. The CSA assists in coordinating enforcement activities and the following self-regulatory organizations (SROs)—the Investment Industry Regulatory Organization of Canada (IIROC), the Mutual Funds Dealers Association (MFDA), and the Chambre de la Sécurité Financière (CSF)—which can discipline member investment dealers or their employees for breaching their rules. Sanctions include suspension and termination of membership or market access and monetary penalties. In 2008, CSA members concluded 123 cases, of which 55 were contested before a tribunal, 40 were settled by agreement, and 28 underwent a court proceeding; in 2009, 141 cases were concluded, of which 37 were contested before a tribunal, 69 were settled by agreement, and 35 underwent a court proceeding.<sup>55</sup> In 2008, C\$12.4 million was ordered in fines and administrative penalties, and C\$1.6 million in costs; in 2009, C\$153.7 million was ordered in fines and administrative penalties; and C\$5.7 million in costs.<sup>56</sup> In addition to monetary orders, courts in Ontario and Quebec ordered jail terms for four individuals, ranging from 30 days to 30 months.<sup>57</sup>

### 2.3 Assessment of Corporate Governance Practices

The TSX's study of Canadian corporate governance known as the Dey Report (1994) contained 14 recommendations to assist TSX-listed companies in their approach to corporate governance. The TSX adopted all 14 recommendations as part of its voluntary "best practice guidelines" in 1995. In 1999, the Institute of Corporate Directors and the TSX sponsored a report *Five Years to the Dey*, which evaluated how Canadian companies were complying with the Dey Report's best practice guidelines. The report concluded that, although most companies took the guidelines seriously, important areas remained where general practice fell short of the guidelines' intent. Subsequently the Canadian Institute of Chartered Accountants (CICA), the TSX and TSXV established a Joint Committee on Corporate Governance in July 2000 (the Saucier Committee). The Saucier Report of November 2001 recommended that the TSX amend its corporate governance guidelines to bring them into line with international developments such as the proposed Sarbanes-Oxley legislation in the US. This ultimately led to the CSA's Corporate Governance Guidelines in 2005, which replaced the TSX's "best practice guidelines."<sup>58</sup> The CSA began a review of its Corporate Governance Guidelines (NP 58-201) and Disclosure of Corporate Governance Practices (NI 58-101) in September 2007, and published for comment proposed changes in December 2008 and, based on the feedback it received, decided to maintain the status quo.

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<sup>55</sup> Source: *Canadian Securities Administrators 2009 Enforcement Report* at [http://www.securities-administrators.ca/uploadedFiles/General/pdfs/CSAReportENG09\[FA\].pdf](http://www.securities-administrators.ca/uploadedFiles/General/pdfs/CSAReportENG09[FA].pdf)

<sup>56</sup> Idem. Note: figures do not include amounts for restitution, compensation and disgorgement.

<sup>57</sup> Idem. Note: additional actions included preventative measures such as interim cease trade and asset freeze orders; reciprocal orders; and cases concluded by SROs (of which there were 55 in 2008 and 97 in 2009).

<sup>58</sup> See: [http://www.osc.gov.on.ca/en/SecuritiesLaw\\_pol\\_20040116\\_58-201\\_pro-multi-pol.jsp](http://www.osc.gov.on.ca/en/SecuritiesLaw_pol_20040116_58-201_pro-multi-pol.jsp)

## 3. Awareness and Advocacy for Good Corporate Governance

### 3.1 Company Directors

Canada has an Institute of Corporate Directors (ICD), which is a not-for-profit, member-based professional association representing Canadian directors and boards across the for-profit, not-for-profit and government sectors. It has more than 4,000 members and a network of nine chapters. The ICD promotes the professionalism and effectiveness of directors by providing professional development activities.

In Canada, there is no obligatory training required to be appointed to or remain a director of a corporation's board of directors. There are, however, three specific education programs for company directors that lead to designations attesting to an individual's competence to hold a director position.

- The ICD and the Rotman School of Management at the University of Toronto have jointly developed the following director education programs: Director Education Program (DEP), and Not-for-Profit Governance Essentials Program. The 12-day DEP course is offered at five universities across Canada. Completion of the DEP is the first step towards obtaining the ICD.D designation granted by the ICD. To date, more than 1,500 directors have earned their ICD.D designation.
- The Directors College, the DeGroot School of Business at McMaster University and the Conference Board of Canada have jointly developed the Chartered Director Program that consists of five modules over a total of 92 hours that leads towards the Chartered Director (C. Dir.) designation. Since it began in 2005, more than 380 directors, CEOs, CFOs and Corporate Secretaries have earned their C. Dir. designation.
- The Collège des Administrateurs de Sociétés of the Université Laval has a program that is delivered in French over 15 days that leads to the “Administrateur de sociétés certifiées” designation. Since it began in 2005, more than 250 individuals have earned their designation.

### 3.2 The Media

The Canadian media, particularly the financial news media, regularly reports on corporate governance issues in Canada and the United States. As an example, the Globe and Mail, an economy-level newspaper, annually publishes *Board Games*, which evaluates and ranks corporate governance practices in Canada.<sup>59</sup>

### 3.3 Educational System

In Canada, corporate governance is not typically in the curriculum of a secondary educational program. It is part of most university Masters of Business Administration and law programs.

### 3.4 The Stock Exchange

The ICD and the TSX collaborate to strengthen board performance by offering all TSX and TSXV issuers the opportunity to conduct searches for directors using the ICD Directors

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<sup>59</sup> See:

<http://www.theglobeandmail.com/report-on-business/board-games/board-games-methodology-corporations/article1374554/>

Register, an economy-level database of highly-skilled professionals who are qualified, available, and prepared to serve on boards.

The TMX Group, which owns the TSX and TSXV, supports the educational needs of its issuers, as well as other companies considering going public, through its TMX Learning Academy, which is an educational platform for information relevant to being or becoming a public company, including corporate governance.<sup>60</sup>

## 4. Corporate Governance of State-Owned and Family-Controlled Enterprises

### 4.1 State-Owned Enterprises

#### 4.1.1 Oversight

In the government of Canada, each Minister is responsible for overseeing the activities of federal Crown corporations within his or her portfolio. The Minister is responsible for: appointments and framework legislation, as applicable; review and approval of corporate plans; assessing the ongoing relevance of the corporation's mandate and its effectiveness as a policy instrument; and providing broad policy direction to the corporation. Though boards of directors are responsible for ensuring that the activities of their corporations are in line with its mandate, the Minister provides the corporation with guidance on the government's objectives and priorities. The Minister is ultimately answerable to Parliament for all of the corporations' activities.

Parliament also plays a significant role in the oversight of federal Crown corporations. It receives key reports (e.g., annual reports and corporate plan summaries) and has the ability to question Ministers on the Crown corporations within their portfolios, allowing it to assess roles, attributes and performance. In addition, parliamentary committees have the authority to invite chairs and CEOs to appear before them to explain the activities of their organizations.

A Cabinet committee, the Treasury Board, also holds certain responsibilities with respect to the governance of federal Crown corporations. Specifically, the Treasury Board: reviews corporate plans and recommends their approval by the Governor in Council; approves capital budgets, and, where required, operating budgets; approves budgetary appropriations to be put to a vote in Parliament; and, makes regulations for their general governance. In addition, the President of the Treasury Board tables in Parliament the *Annual Report to Parliament on Crown Corporations and Other Corporate Interests of Canada*, which provides information on their activities, as well as their compliance with tabling requirements for annual reports and summaries.<sup>61</sup>

#### 4.1.2 Specific Corporate Governance Requirements

The accountability structures and governance requirements for federal Crown corporations are defined by the *Financial Administration Act* and specific enabling legislation in some cases. However, there are other instruments that the government can use to influence their activities. These include the ability to: amend constituent legislation; review and amend corporations' mandates; review and approve corporations' corporate plans; and issue formal directives

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<sup>60</sup> See: <http://www.tmx.com/en/listings/learning/index.html>

<sup>61</sup> <http://www.tbs-sct.gc.ca/reports-rapports/cc-se/index-eng.asp>

requiring Crown corporations to perform a specified action or carry out a certain activity which meets the government's priorities.

In addition, the Treasury Board Secretariat, which, inter alia, is responsible for advising the Treasury Board on issues that affect federal Crown corporations, produces guidance for Crown corporations on a range of governance matters, including (but not limited to): directors' roles and responsibilities; audit committees; evaluating board effectiveness; corporate plans; and annual public meetings and outreach. Although the guidance is not legally required, Crown corporations are strongly encouraged to follow the best practices contained in it.

#### **4.1.3 Important Corporate Governance Issues**

In the past, the governance and activities of federal Crown corporations have come under scrutiny, often as a result of reports by the Auditor General of Canada identifying governance deficiencies. To address issues raised in the reports and to strengthen their overall governance regime, the government tabled in Parliament in 2005 the *Review of the Governance Framework for Canada's Crown Corporations: Meeting the Expectations of Canadians*.<sup>62</sup> The Review outlines 31 measures designed to improve Crown corporation governance by: clarifying accountabilities, enhancing board effectiveness, strengthening the audit regime, improving the appointment process, and increasing transparency. The majority of measures have now been implemented through legislation, publication of guidance, or by voluntary adoption by Crown corporations. Furthermore, the government has continued to introduce new measures designed to keep the Canadian system at the leading edge in terms of implementation of best practices.

#### **4.1.4 Are State-Owned Companies Good Examples of Corporate Governance?**

Federal Crown corporations have a robust system of governance, which has improved significantly over the past five years through, inter alia, the implementation of the *Review of the Governance Framework for Canada's Crown Corporations*. Consequently, the Crown Corporation governance system compares well with international standards, notably the *OECD Guidelines on Corporate Governance of State-Owned Enterprises*.<sup>63</sup>

The first OECD guideline recommends the establishment of an effective legal and regulatory framework for state-owned enterprises. In Canada, this is provided for by Part X of the *Financial Administration Act* (FAA).

The second OECD guideline advises that the state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of state-owned enterprises is carried out in a transparent and accountable manner. In Canada, the FAA or, in some cases, individual enabling legislation, defines the ownership, lines of accountability and reporting requirements. Crown corporations have operational autonomy to achieve their defined objectives: they operate at arm's length from government in terms of the management of their financial, human and physical assets, and oversight is delegated to the board of directors. As per the OECD guideline, the board of directors is held accountable to Parliament, and each Crown corporation reports through their Minister to Parliament (with certain exceptions), Crown corporations also submit annually a corporate plan, a capital and an operating budget, and an Annual Report.

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<sup>62</sup> <http://www.tbs-sct.gc.ca/report/rev-exa/gfcc-cgse-eng.asp>

<sup>63</sup> <http://www.oecd.org/dataoecd/46/51/34803211.pdf>

The third OECD guideline calls for the equitable treatment of shareholders and equal access to corporation information. In Canada, federal Crown corporations are required by law to respond to public demands for information on their activities under the *Access to Information Act*. Other information on Crown corporations is available in the Annual Report to Parliament on Crown Corporations and Other Corporate Interests of Canada.

The fourth OECD guideline advises that state ownership policy fully recognizes state-owned enterprises' responsibilities towards stakeholders. In Canada, federal Crown corporations are required by law to hold annual public meetings to permit the public and stakeholders the opportunity to question the corporation's management.

The fifth OECD guideline calls for state-owned enterprises to observe high standards of transparency, including through the aggregate reporting on state-owned enterprises on an annual basis, the development of efficient internal audit procedures, and, in the case of large state-owned enterprises, being subjected to an independent external audit. In Canada, all Crown corporations are subject to annual financial audits and periodic special examinations (i.e., performance audits) carried out (solely or jointly) by the Auditor General of Canada. The independence of the audit function is protected by requiring that internal and external auditors report directly to the corporation's audit committee. Beginning in April 2011, all parent Crown corporations will also be required to publish quarterly financial statements. As per the OECD guideline, disclosure of material information on matters of significant concerns is observed and, in this regard, "whistleblower" employees who disclose wrongdoing in their organizations are protected under the *Public Servants Disclosure Protection Act*.

The sixth and last OECD guideline recommends that the boards of state-owned enterprises be given the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management. In Canada, the government has enacted legislative changes to strengthen Crown corporation board independence by: splitting the CEO/chairman role into two separate positions; and requiring the CEO to be the sole representative of management on a board of directors. The boards' effectiveness has also been enhanced by the establishment of board charters to guide their operations/mandate. Boards also perform regular assessments of their members' effectiveness. To further enhance Crown corporation directors' skills and help them better understand their role, the Canadian government offers orientation training to new directors and education programs are also available.

## 4.2 Family-Controlled Enterprises

Canadian corporate ownership is highly concentrated, with close to 55% of Canadian companies being family-controlled.<sup>64</sup> Historically, family-controlled companies, in their quest to gain capital but retain family control, have issued shares with dual voting rights, preserving high-voting stock for the family and selling restricted-voting shares to the public.<sup>65</sup> The Canadian Coalition for Good Governance supports the elimination of dual-class shares, believing that voting interest should be commensurate with economic interest. The issue is a minor one; however, as dual-class shares have their benefits too: some of Canada's best-performing companies have multiple-voting shares and their shareholders with restricted voting rights are generally unperturbed.

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<sup>64</sup> Morck, Randall, Michael Percy, Gloria Tian & Bernard Yeung. 2005, "The Rise and Fall of the Family Firm—A History of Corporate Governance in Canada", in R. Morck, ed. *A History of Corporate Governance around the World*.

<sup>65</sup> See: <http://www2.parl.gc.ca/Content/LOP/ResearchPublications/prb0526-e.htm>

There is no indication that family-owned enterprises consider corporate governance requirements a disincentive to becoming listed companies.

## 5. Role of Professional Service Providers in Corporate Governance

Professional service providers—particularly accounting and auditing firms, law firms and corporate governance consultants (e.g., Conference Board of Canada)—in addition to assisting companies in respect of corporate governance matters, often write articles or hold seminars on corporate governance issues that inform the public in general.

## 6. Recent Developments in Corporate Governance

### 6.1 Corporate Governance Developments

During the last three years, a notable corporate governance development has been the improvements in executive compensation disclosure and the gain in momentum on “Say on Pay” for Boards of Directors. The CSA made consequential amendments to NI 51-102 *Continuous Disclosure Obligations* in order to improve the communication of payments and awards to certain executive officers and directors, which took effect as of 2009. The Canadian Coalition for Good Governance established a *Shareholder Engagement and “Say on Pay” Policy* in April 2009, which supported regular, constructive engagement between institutional shareholders and the boards and board compensation committees of public corporations to explain their perspectives on governance, compensation and disclosure practices.<sup>66</sup> It followed up with a *Model Shareholder Engagement and “Say on Pay” Policy for Boards of Directors* in January 2010, following significant discussions with a variety of issuers who have publicly announced that they will be holding “Say on Pay” shareholder advisory votes in 2010.<sup>67</sup> To this point, 35 Canadian companies have adopted a “Say on Pay”.<sup>68</sup>

The Ontario Securities Commission (OSC), in its 2009 decision on the matter of HudBay Minerals’ acquisition of Lundin Mining Corporation that ultimately led to its withdrawal, pointed to a conflict of interest whereby an independent financial advisor providing a fairness opinion received a success fee. The decision is expected to change the manner in which financial advisors are retained and compensated for M&A transactions.

Corporate social responsibility (CSR) has become increasingly important in recent years, with many Canadian companies developing codes of conduct and best practices to guide their operations domestically and overseas.<sup>69</sup>

### 6.2 Enforcement of Corporate Governance Rules

A noteworthy CSA case was that pertaining to the Asset Backed Commercial Paper (ABCP) market failure—Canada’s home-grown financial failure during the financial crisis. Classified

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<sup>66</sup> See: [http://www.ccg.ca/site/ccgg/assets/pdf/CCGG\\_SOPP\\_Final.pdf](http://www.ccg.ca/site/ccgg/assets/pdf/CCGG_SOPP_Final.pdf)

<sup>67</sup> See: <http://www.ccg.ca/site/ccgg/assets/pdf/CCGG-Say-on-Pay-Final.pdf>

<sup>68</sup> See: <http://www.share.ca/pay>

<sup>69</sup> For more information, see: [http://www.international.gc.ca/trade-agreements-accords-commerciaux/ds/activity-csr.aspx?menu\\_id=4&menu=R](http://www.international.gc.ca/trade-agreements-accords-commerciaux/ds/activity-csr.aspx?menu_id=4&menu=R)

as a Misconduct by Registrants, eight non-bank financial institutions agreed to pay financial penalties for failing to respond adequately to emerging issues in this market, which seized up in 2007 and left investors holding illiquid payments. In particular, they did not disclose to all their clients an email dated 24 July 2007 from Coventree Inc.—the largest sponsor of ABCP in Canada—providing the subprime exposure of each Coventree ABCP conduit. In December 2009, Quebec’s Autorité des Marchés Financiers, OSC, and IIROC reached a settlement providing for a payment totalling almost C\$139 million in administrative penalties and investigative costs.<sup>70</sup>

## 6.3 Current Issues and Challenges for Corporate Governance

### 6.3.1 Challenges

Investor fraud cases increased during the financial crisis, with an increasing number of Ponzi schemes exposed.

### 6.3.2 Priorities for Reform

With the increase in investor fraud cases, fostering confidence in capital markets will be an essential component of securities law enforcement going forward, and early intervention to prevent harm a key priority.

The *Canada Business Corporations Act* is currently undergoing a five-year review by the House of Commons Standing Committee on Industry, Science and Technology. In its brief to the Committee, the Canadian Coalition for Good Governance in seeking greater protection for shareholders from the actions of management and directors, setting out 11 shareholder democracy recommendations.<sup>71</sup>

### 6.3.3 Financial Crisis

As the OECD has indicated, the central corporate governance question arising from the financial crisis is: what can be done to improve how financial firms operate?<sup>72</sup> In this regard, the OECD sees four areas for urgent action: corporate risk management; pay and bonuses; the performance of board directors; and the need for shareholders to be more proactive in their role as owners. Since the financial crisis impacted Canada relatively less than other OECD economies, the imperative to bring reform in these areas, while desired, is not as profound.

Nonetheless, the failure of Canada’s ABCP market exposed serious shortcomings in corporate governance that were underscored in the October 2008 IIROC regulatory study of the problem.<sup>73</sup> Essentially, dealer members did not consider third-party ABCP to be a new product requiring corporate governance oversight and risk management; instead, they viewed this risky product as an accepted form of commercial paper. The IIROC study made recommendations in respect of product due diligence, product transparency, conflicts of interest and clear disclosure to customers, and credit ratings. The January 2009 report of the Expert Panel on Securities

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<sup>70</sup> See: [http://www.securities-administrators.ca/uploadedFiles/General/pdfs/CSAReportENG09\[FA\].pdf](http://www.securities-administrators.ca/uploadedFiles/General/pdfs/CSAReportENG09[FA].pdf)

<sup>71</sup> See: [http://www.ccg.ca/site/ccgg/assets/pdf/Brief\\_to\\_Standing\\_Committee.pdf](http://www.ccg.ca/site/ccgg/assets/pdf/Brief_to_Standing_Committee.pdf)

<sup>72</sup> See: [http://www.oecdobserver.org/news/fullstory.php/aid/2931/Corporate\\_governance:\\_Lessons\\_from\\_the\\_financial\\_crisis.html](http://www.oecdobserver.org/news/fullstory.php/aid/2931/Corporate_governance:_Lessons_from_the_financial_crisis.html)

<sup>73</sup> See: <http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=3CAB660DB44E41C2875DD3DBD27FAD EA&Language=en>

Regulation (the Hockin Report), *Creating an Advantage in Global Capital Markets*, argued that the ABCP failure provided a strong reason for a single Canadian Securities Commission to replace the provincial-territorial structure currently in place, owing to the slow release of the CSA consultation paper that was published over a year after the failure.<sup>74</sup> The CSA consultation paper, inter alia, raised concerns about credit rating agency governance and proposed a new credit-rating agency regulatory framework.<sup>75</sup>

## Corporate Governance Rules and Practices in Canada

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for shareholders' meetings?	X		CL	Rarely. A shareholder (or a group of shareholders) holding 1% of outstanding shares or C\$2,000 worth of shares can propose a matter be raised at a shareholders' meeting. The proposal can include nominations for director if signed by one or more shareholders holding in all 5% of shares.
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		CL	Typically.
3. Must company transactions with its insiders be on a non-preferential basis?	X		SL	
4. Is a super majority vote required for major company acts affecting shareholder rights?	X		CL	
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors?		X	CGC	Typically. Having independent directors on boards is recommended by the Securities Commissions' Corporate Governance Guidelines.
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?	X		CL, SL	The answer is yes with respect to (a) but uncertain with respect to (b). Regarding (b), it is considered a good practice but independent directors' oversight of executive compensation is not mandatory.
7. Do independent directors decide what information the board receives from management?	X			
8. Are the chairman of the board and chief executive officer different persons in the majority of listed companies?		X	CGC	Typically. Separation of positions of chairman of the board and chief executive officer is recommended by the Securities Commissions' Corporate Governance Guidelines
9. Are all board members elected annually?	X		GP	Typically. Corporate statutes allow directors to be elected for a maximum term of three years. However, most are elected for a one-year term.

<sup>74</sup> See: <http://www.expertpanel.ca/eng/reports/index.html>

<sup>75</sup> See: [http://www.lautorite.qc.ca/userfiles/File/projets-speciaux/turbulence-credit/11-405\\_ABCP\\_Cons\\_Paper\\_2008-10-10\\_ang.pdf](http://www.lautorite.qc.ca/userfiles/File/projets-speciaux/turbulence-credit/11-405_ABCP_Cons_Paper_2008-10-10_ang.pdf)

Element	Yes	No	Source(s) of Rule	Comments
10. Does the board oversee enforcement of a company code of conduct?	X		GP	Typically. Most large publicly-traded corporations have their own code of conduct.
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with International Financial Reporting Standards (IFRS)?	X		SL	Canada is incorporating IFRS in 2011. The changeover transition is currently underway.
12. Is the identity of the five largest shareholders disclosed?	X		SL	
13. Is compensation of company executive officers disclosed?	X		SL	
14. Are extraordinary corporate events disclosed?	X		SL	
15. Are risk factors disclosed in securities offering materials?	X		SL	
16. Are transactions of a company with its insiders disclosed?	X		SL	

*Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory*

# Chile

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in Chile

#### 1.1 Background

Chile's main legislation and regulation on corporate governance is as follows:

**Securities Markets Law (Law 18.045):** Enacted in 1981 and subsequently modified and improved on several occasions, this law governs the public offering and trading of securities, the markets in which these are traded, their issuers and the intermediaries that operate in these markets. It establishes standards that promote market transparency and effectiveness, such as opportune and accurate disclosure of relevant information about issuers of publicly-traded securities.

**Law on Corporations (Law 18.046):** Also enacted in 1981 and later modified and improved on several occasions, this law establishes the definition of a public company, classifies public companies, regulates their administration and operation, and defines the bodies that comprise these companies. It establishes a framework that facilitates shareholders' exercise of their rights and their equitable treatment, including that of minority shareholders. In addition, it establishes that the body principally responsible for a company's administration is the board of directors and regulates the responsibility of directors towards shareholders.

**Law governing the Superintendency of Securities and Insurance (SVS), enacted in 1980:** The SVS is the body responsible for overseeing compliance with the Securities Markets Law, for drawing up the regulation necessary for its implementation, and supervising companies issuing securities or that register securities with the SVS. This supervision is essential to ensure that the legal and regulatory framework on corporate governance is effective in practice.

**Law governing the Superintendency of Banks and Financial Institutions (SBIF):** The SBIF is the body responsible for regulating the banking industry and for supervising compliance of banks, as among the most important players and intermediaries in the financial market, with the corresponding legislation and regulation.

**Law governing the Superintendency of Pensions (SP):** The SP is the body responsible for regulating and supervising Pension Fund Administrators (AFPs) and ensuring their compliance with the corresponding regulation. AFPs are among Chile's main institutional investors and, therefore, play a fundamental role in the implementation of good corporate governance practices.

Circulars, Official Letters and General Regulations issued by the SVS, SBIF and SP: They seek to perfect, clarify and update the regulation and functioning of the securities market and companies participating in it.

Regarding stock exchange listing requirements, the Santiago Stock Exchange (SSE), which concentrates the vast majority of trading, listings and liquidity, imposes no additional requirements on issuers beyond what the law requires. While the SSE may halt trading in a share for up to five days if insider trading is suspected or there is unusually volatile trading, this is a rare occurrence, and occasional insider trading episodes are widely held to occur.

Historical issues have spurred the development of the legal and institutional basis described above. It has been argued, for example, that the establishment of a privately administered, defined-contribution pension system in 1982, as it focused public attention on financial markets, may have served to improve the quality of regulation, including the regulation of corporate governance.

Specific events and crises have also served to improve financial market regulation and corporate governance: the 1982-3 banking crisis led to the 1986 banking law restricting related lending and eliminating bank ownership of equity; the control premium paid for Enersis in 1999 and the sale to the controller Telefónica España of the CTC subsidiary Telefonica.net led to the 2000 corporate governance law effectively eliminating dual class shares and establishing a directors' committee to review related party transactions; the CORFO (Chile's Economic Development Agency) – Inverlink financial scandal led to aspects of the MK II law regarding improved security and dematerialization of financial instruments, and perhaps more tenuously, the 2004 sale to the controller Telefónica España of CTC's mobile telephony subsidiary has led to calls for further enhancement of minority shareholder protection.

## 1.2 Trends

Chile has three stock exchanges: the Santiago Stock Exchange (SSE), the Electronic Stock Exchange (ESE) and the Valparaíso Stock Exchange (VSE). The table below only focuses on the SSE, since it concentrates the vast majority of trading, listings and liquidity.

Year	Number of Companies	Market Capitalization (Million USD of Dec. '09)
2005	245	151.940
2006	244	197.024
2007	238	225.005
2008	235	164.484
2009	232	233.401

Source: SSE

## Key Corporate Governance Rules and Practices

The annex covers key corporate governance rules and practices in Chile in relation to rights of shareholders, the composition and responsibilities of the board of directors, and the transparency of companies regarding their operations and financial condition.

## **2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules**

### **2.1 Development of Corporate Governance Rules**

In recent decades, Chile has carried out a continual process of legislative and administrative reforms that has allowed its capital market to develop and has left the economy in a good position to confront the challenges of increasingly complex and dynamic global markets.

The Ministry of Finance has played a leading role in this process. One of the main roles of the Ministry is to monitor the local financial system and its impact on other sectors in the economy in terms of immediate and long-term issues related to the development of capital markets. It also provides support on public policy issues that have financial components, even though they may be associated with other areas of the economy, such as pension reform. In this context, the Ministry of Finance has developed and supported legal initiatives to regulate the financial system, including corporate governance issues, as was the case with the Corporate Governance Law recently approved (more details in Section 6).

The Ministry of Finance has also worked actively with entities responsible for regulating the financial system – such as Chile’s Central Bank, the Superintendency of Pension (SP), the Superintendency of Securities and Insurance (SVS), and the Superintendency of Banks and Financial Institutions (SBIF) – and with the capital markets advisory council, which is made up of members from different private sectors, to resolve issues related to the modernization of the financial system.

Finally, it is worth recalling that Circulars, Official Letters and General Regulations issued by the SVS, SBIF and SP seek to perfect, clarify and update the regulation and functioning of the securities market and companies participating in it.

### **2.2 Enforcement of Corporate Governance Rules**

The Law on Corporations, the Securities Market Law and other relevant laws grant supervising entities with appropriate authority, power and control mechanisms for the fulfillment of their duties, particularly in overseeing the implementation of laws and regulations. Supervisory bodies’ rulings are public and subject to the scrutiny of the courts when necessary.

The Superintendency of Securities and Insurance (SVS), the main supervisory entity for the capital markets, is an autonomous corporate body affiliated with the Chilean government through the Ministry of Finance. It was created in 1980 and the head is the Superintendent, who is its judicial and out-of-court legal representative, appointed by the President of the Republic. It is responsible for the supervision of all activities and entities involved in Chilean securities and insurance markets, such as, listed corporations, issuance of securities for public offer (stocks, bonds, commercial papers, investment fund shares), stock exchanges, clearinghouses, security brokers, external auditors, mutual fund managers and their funds, investment fund managers and their funds, foreign capital investment funds and their funds, risk-rating agencies, securitization companies, mortgage mutual fund managers and their funds, centralized security deposits, among others. The SVS enforces compliance with all laws, regulations, by-laws, and other provisions governing the operation of these markets.

On the other hand, institutional investors have decisively influenced corporate governance in Chile, pressing for more disclosure requirements and for the protection of minority shareholders rights. In fact, a section of the pension fund law explicitly promotes corporate governance safeguards and a minimum free float of 35% (making 2/3 control impossible). Additionally, pension funds have self-regulated their votes for directors<sup>76</sup> and have also been using external head-hunting firms to draw up lists of potential candidates, so as to professionalize the selection process.

### **2.3 Assessment of Corporate Governance Practices**

In 2003, the World Bank – IMF Report on the Observance of Standards and Codes (ROSC) reported broad compliance with corporate governance principles in Chile, with no principle deemed “not observed.” The key weaknesses highlighted in the report were poor disclosure of capital structures that allow shareholders to separate control and cash flow rights; general disclosure; auditing; and board functioning, including the definition of board member independence. Later on, in 2008, Chile undertook a self-assessment process with respect to the observance of the OECD Principles of Corporate Governance as part of its entry process to the OECD, already completed.<sup>77</sup> The state of affairs seems to have improved substantially: all of the OECD Principles of Corporate Governance were identified as either fully or broadly implemented.

## **4. Corporate Governance of State-Owned and Family-Controlled Enterprises**

### **4.1 State-Owned Enterprises**

Chile recognizes the importance of improving the corporate governance of State-Owned Enterprises (SOEs) and accepts the philosophy of applying as far as possible norms for private-sector companies to state enterprises.

The economy’s current norms in this area are consistent with the principles stated above. Those norms include the ones that created the System of State Enterprises (SEP) and regulate its powers. The SEP is a committee, without independent legal status, created by the Corporación de Fomento de la Producción, CORFO (Chile’s Economic Development Agency), to represent the interests of the Republic and, in particular, those of CORFO in most of the enterprises in which it is a partner, shareholder or owner. It does so by appointing directors and controlling the strategic management of the enterprises under its responsibility.

In this line, a code drawn up in 2008 by the SEP for the State enterprises under its tuition aims to establish homogeneous management policies applicable to all SOEs and to provide them with common norms and guidelines for the achievement of efficiency, effectiveness, probity and transparency in their management. A bill presented by the government in 2007 and

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<sup>76</sup> Their self-imposed selection criteria now exclude voting for candidate directors that (i) are ex-executives of the firm; (ii) were previously voted onto the board by the controller; (iii) have been on the board for six years or more; or (iv) have more than one other directorship.

<sup>77</sup> On 7 May 2010 Chile completed the last step in its path to OECD membership. In signing the OECD Convention, Chile pledged its full dedication to achieving the Organisation’s fundamental aims and became the first South American economy to join the OECD.

nowadays being discussed in Congress, aims at legally validating the principles stated in this code.

## **4.2 Family-Controlled Enterprises**

In Chile, family owned conglomerates make up an important proportion of the controlling shareholders. The main corporate governance issues relating to the way family-controlled corporations operate are the presence of non-professional directors (many of them blood relations to the head of the company) and relating to the risk management of the company that generational succession poses.

## **5. Role of Professional Service Providers in Corporate Governance**

The Chilean corporate governance framework relies heavily on advice and research provided by analysts, brokers, rating agencies and others, which are relevant for investors' decisions. The Securities Markets Law and the Law on Corporations prescribe the duties of all such advisors and analysts, preventing conflicts of interest and promoting transparency.

The Corporate Governance Law recently approved (more details in Section 6) reinforces this approach by requiring all such entities to adopt and make public their policy regarding use of privileged information, internal research, and prevention of front running. Also, the Corporate Governance Law enhances the rule that penalizes the spreading of rumors or false information about listed firms or securities. Moreover, it states that material information delivered to analysts should be simultaneously disclosed to the market, according to the administrative regulations of the SVS.

## **6. Recent Developments in Corporate Governance**

### **6.1 Corporate Governance Developments**

#### ***Corporate Governance of Private Enterprises***

On 1 January 2010, a new law on corporate governance (Law No. 20.382, the "Corporate Governance Law") was enacted drawing on OECD guidelines and other standards, in order to comply with best international practices in this field, which introduced significant changes to Law No. 18,046 (the "Corporations Law") and Law No. 18,045 (the "Securities Market Law"). A summary of the most relevant aspects of this law is found below.

#### ***Independent Directors***

According to the amended Article 50 bis of the Corporations Law, listed corporations shall appoint at least one independent member to the Board of Directors, if the following conditions are met: (i) the market capitalization is equal or greater than 1,500,000 UF (approximately US\$56 million); and (ii) at least 12.5% of the voting shares outstanding are held by shareholders that individually owns or controls less than 10% of the voting shares. Regarding this matter, stricter and more objective criteria for determining directors' independence were established.

### *Directors' Committee*

Listed corporations meeting certain market capitalization and ownership dispersion thresholds must set up a directors' committee, which will need to be comprised of three members. This committee will have more authority to revise aspects related to the progress of the company, related party transactions and the interaction with auditors, proposing to the board of directors the best way to proceed in each case.

The majority of the directors' committee members shall be independent directors if certain additional requirements are met. In case of disagreement in their nomination, the board shall prefer those directors elected with a larger percentage of minority shareholders votes. On the other hand, if there is only one independent director, such board member shall designate the remaining committee members among the non-independent directors. The chairman may not serve on the committee or any subcommittee, except in the case of independent directors.

### *New Responsibility of the Board of Directors Regarding Information*

The Corporate Governance Law established that the board of directors shall be responsible for taking actions to avoid the disclosure of information related to the corporation's legal, economic and financial situation, before it's provided to the shareholders and the public, to persons that should not need to have access to the information considering its position or activity in the company.

### *Prohibitions of the Board of Directors' Members*

Members of the board of directors shall not propose amendments to the bylaws, agree on the issuance of bearer securities or adopt policies or decisions that are not in the corporation's best interest. Additionally, the bill extends the prohibitions of the directors on preventing or obstructing any investigations aiming to establish the responsibility in the management of a corporation, to chief officers, managers and key staff of such corporation. Finally, the law also extends the directors' prohibition on inducing to provide irregular accounts, submit false information and conceal information to the managers, key staff, employees, external auditors and rating agencies.

### *Extraordinary Shareholders Meetings*

The Corporate Governance Law introduces, as new matters that need to be agreed in an extraordinary shareholders meeting and require two thirds of the voting shares, the following:

- The sale of 50% or more of the assets of a corporation's affiliate, if that sale represents at least a 20% of the assets of such corporation.
- Any sale of shares of a corporation's affiliate that would result in the parent corporation losing its control over the affiliate company.
- The power to exercise squeeze out rights.
- The approval or ratification of acts or agreements to be entered into or entered into with related parties.
- An amendment of the bylaws aiming to extend the term of a preference share. In this case, the amendment shall be agreed by two thirds of the respective class of shares.

### *Redemption Rights*

Amended Article 69 of the new law states that shareholders shall have redemption rights in the case of (i), (ii) and (iii) of the precedent number. Additionally, the minority shareholders shall

also have redemption rights, in case the majority shareholder acquires more than 95% of the outstanding shares of a listed corporation.

### *Related Party Transactions*

The Corporate Governance Law includes an entirely new title to the Corporations Law (Title XVI) in order to regulate potential conflict of interest in transactions between the corporation and related parties. Although the existing Corporations Law deals with this matter, the new bill expands the definition of related party, includes new procedures and quorums for the approval of such transactions and specifies the prohibition of taking corporate opportunities by any director, chief officer, manager, key executive or controlling shareholder, also including any of their related persons.

### *Infringement of Related Party Transactions' Provisions*

Without prejudice of other sanctions that may be available, the breach of any of the obligations mentioned above, will not affect the validity of the transaction. However, the corporation or shareholders may demand from the breaching party, the reimbursement, in favor of the corporation, for an amount equivalent to the benefits gained by the breaching party as consequence of the transaction. Additionally, the shareholders and the corporation may claim damages. Finally, the breaching party bears the burden of proof that the transaction was carried out according to the law.

### *Taking of Corporate Opportunity*

The new Article 148 of the Corporations Law specifies the prohibition of taking corporate opportunities, establishing that no director, manager, main executive, liquidator, controller or their related persons may use any business opportunities they may know about because of their position in their own benefit. For this purpose, business opportunity shall mean any exclusive plan, project, opportunity or proposal directed to the corporation, aimed to undertake a profitable activity related or complementary to the corporation's line of business.

### *Privileged Information*

The amended article 165 of the Securities Market law imposes the obligation to any person with access to inside information because of his/her job, position, activity or relationship with the securities issuer or with the persons mentioned in article 166 of the same law shall maintain strict reserve, and may not use such information to his own benefit nor to the benefit of another, nor purchase or transfer for himself or for others, personally or through third parties, the securities he has inside information about. The rule that establishes the persons who are assumed to have access to inside information was extended.

### **Corporate Governance of State-Owned Enterprises**

The government presented two bills in 2007 that seek to modernize corporate governance of SOEs. One addresses governance in the Corporación Nacional del Cobre de Chile (CODELCO), the state-owned copper producer,<sup>78</sup> and the other one addresses governance in

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<sup>78</sup> CODELCO is of great importance to the state of Chile and makes a crucial contribution to fiscal revenue. It should be noted that it is the world's largest copper producer and Chile's largest company. It is totally state-owned and has a 16,000-strong workforce. For this and other reasons, it represents a special case among SOEs in Chile, warranting individual attention and its own bill.

most of Chile's SOEs. The first was approved in November 2009 and the other is being discussed in the Congress.

Specifically, the law that addresses governance in CODELCO introduces important modifications to its statutes, among which are the strengthening of the board of directors, the increased transparency and supervision, and an institutional redesign. In turn, the other bill would strengthen corporate governance in SOEs, creating a modern and uniform regulatory framework, in order to increase transparency and the quality of management and supervision, based on three pillars: the redesign of the SEP Council; the strengthening of boards of directors; and the increased transparency and supervision.

## **6.2 Enforcement of Corporate Governance Rules**

The Superintendency of Securities and Insurance (SVS), the main supervisory entity for the capital markets, has taken several regulatory enforcement actions against companies over the last two years, but only one of them has been related to the non-compliance of corporate governance rules. In December 2009, the SVS sanctioned the board of directors and the management of Farmacias Ahumadas S.A. (FASA), involved in a case of collusion, for violating article 41 of the Law on Corporations, which establishes a standard for the fulfillment of their duties. Specifically, the SVS fined the board of directors of FASA for not exercising their right to be fully informed, established by article 39 of the Law on Corporations, and the president of the board and the company's CEO for concealing relevant information to the board.

## **6.3 Current Issues and Challenges for Corporate Governance**

### **6.3.1 Challenges**

Chilean listed companies show a high level of ownership concentration and many of them are part of major conglomerates. A consequence of this situation is that one of the central corporate governance challenges in Chile is to prevent the risk of minority shareholder expropriation at the hands of controlling shareholders, who do not face the standard "vertical" principal-agent problem of separation of ownership and control in which company management (the effective controlling party) is difficult to monitor and call to account. Instead, in Chile the controlling party is also in effect the manager of the company, and thus to an extent an agent of the minority shareholders: a "horizontal" principal-agent problem. Two high-profile cases of sales of subsidiaries of a listed firm with significant pension fund minority shareholdings to controlling party companies at allegedly below-market prices have highlighted the importance of potential minority shareholder expropriation.

Moreover, ownership concentration implies the absence of a market for corporate control (i.e. hostile takeovers) a standard palliative of the principal-agent problem in Berle and Means-type corporations. Minority expropriation is likely to be especially acute when cash flow rights are separated from voting rights by mechanisms such as pyramid schemes, cross shareholdings, and dual-class shares. While cross shareholdings are illegal in Chile and use of dual-class shares is limited, pyramids are a feature of the domestic corporate landscape. Despite this, controllers in Chile tend to own more equity than is necessary for control, as the low levels of free float attest.

### **6.3.2 Priorities for Reform**

The Ministry of Finance has recently announced a new capital markets reform agenda, denominated Mercado de Capitales del Bicentenario (Bicentenary's Capital Markets) or MKB,

to be developed during the next four years. One of the main issues that this agenda will address is the governance of the Superintendency of Securities and Insurance (SVS) in order to confer the institution higher levels of autonomy and a more robust structure, among others. In doing so, the reform would reduce the risks of political interference and discretionary behavior in the fulfillment of the Superintendency's capital markets supervisory role.

At the same time, the Ministry of Finance is currently drafting the amendment to the Reglamento de Sociedades Anónimas (Regulation on Corporations Law) enacted in 1982, in order to update it in accordance to the latest legal changes—especially the new law on corporate governance—and the jurisprudence and doctrine of the SVS.

### 6.3.3 Financial Crisis

The positive performance of the Chilean economy during the recent global financial crisis reaffirms the development of the economy's capital markets and the solidity of its financial system. Largely, Chile's favorable situation in this respect is in part due to a good corporate governance framework, in line with best international practices in this field. It's worth noting, for example, that Chilean banks did not present balance sheet issues nor did they indulge in irresponsible behavior that could have exacerbated the restricted credit conditions globally. In general terms, the Chilean corporate sector performed well during the crisis and avoided many of the major failures observed in other economies.

## Key Corporate Governance Rules and Practices in Chile

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for shareholders' meetings?	X		CL	Shareholders in possession of more than 10% of the company's equity can convoke to shareholders' meetings in order to discuss special topics.
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		GP	
3. Must company transactions with its insiders be on a non-preferential basis?	X		CL	
4. Is a super majority vote required for major company acts affecting shareholder rights?	X		CL	The agreements of the special shareholders' meeting that imply the amendment of the corporate by-laws or the elimination of the annulment of modifications caused thereby due to irregularity of procedures, shall be adopted with the majority stipulated in the by-laws, which in closely-held corporations may not be less than the absolute majority of the voting shares issued.  Agreements related to the extraordinary matters of article 67 require the favorable vote of two thirds of the voting shares.
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors? What percentage?	X		CL	Listed corporations shall appoint an independent member to the Board of Director, if the following conditions are met: (i) the shareholders equity is equal or greater than 1,500,000 UF (approximately US\$56 million); and (ii) at least 12.5% of the voting shares outstanding are held by shareholders that individually owns or controls less than 10% of the voting shares.
6. Do independent directors have significant influence	X		CL	Listed corporations meeting certain market capitalization and ownership dispersion thresholds must set up a Directors'

Element	Yes	No	Source(s) of Rule	Comments
over (a) internal and external audit and (b) executive compensation?				Committee, which will need to be comprised of three members. The majority of them shall be independent directors if certain additional requirements are met.
7. Do independent directors decide what information the board receives from management?		X		
8. Are the chairman of the board and chief executive officer different persons in the majority of listed companies?	X		CL	The position of manager is incompatible with that of corporation chairman, auditor or accountant and, for listed corporations, also with that of member of the board.
9. Are all board members elected annually?		X	CL	The board of directors shall be completely renewed at the end of the period stated in the bylaws, which may not exceed three years. The board members may be reelected indefinitely in their functions. If the by-laws should not expressly provide otherwise, the board of directors shall be renewed every year.
10. Does the board oversee enforcement of a company code of conduct?		X		
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with International Financial Reporting Standards?	X			To date, for listed corporations only.
12. Are the identities of the five largest shareholders disclosed?	X		SL	
13. Is compensation of company executive officers disclosed?		X		
14. Are extraordinary corporate events disclosed?	X		SL	Listed corporations and entities under the SVS supervision shall disclose truthfully, sufficiently and promptly, any material or essential information about themselves and their business when it occurs or becomes known to them.
15. Are risk factors disclosed in securities offering materials?	X		SL	SVS regulates the content of the prospectus and any other information to be disclosed in offering materials.
16. Are transactions of a company with its insiders disclosed?	X		CL	A corporation may exclusively enter into contracts or agreements in which one or more board members have an interest or as representatives of a third party, when such operations are previously known and approved by the board and fulfill equity conditions similar to those usually prevailing in the market. The agreements that the board may adopt in this respect shall be notified by the chairman in the following shareholders' meeting and the matter must be mentioned in the summons to the meeting.  The acts or contracts referred to in the foregoing paragraph, as well as the designation of the independent evaluators, shall have the character of an essential event (and therefore informed to the SVS).

Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory

# Hong Kong, China

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in Hong Kong, China

#### 1.1 Background

The main laws, rules and regulations concerning corporate governance-related matters are:

The Companies Ordinance (Cap. 32) (CO)—The CO is one of the main legislations that contain provisions relating to corporate governance. It provides the legal framework which enables the business community to form and operate companies. It also sets out the parameters within which companies must operate, so as to safeguard the interests of those parties who have dealings with them, such as shareholders and creditors. The CO governs, inter alia, the incorporation of companies; management and administration of companies, disclosure by companies of their operations and financial condition; dealing by directors; shareholder remedies and winding up of companies.

A significant proportion of companies listed in Hong Kong, China (HKC) are incorporated outside Hong Kong, in places like Bermuda, the Cayman Islands and the People's Republic of China. These companies are not subject to the CO, but must comply with the relevant company law of their economy of incorporation;<sup>79</sup>

The Securities and Futures Ordinance (Cap. 571) (SFO)—The SFO provides the regulatory and legal framework for the regulation of securities and futures market in Hong Kong. It provides, amongst others, the legal requirements relating to disclosure of interest in listed corporations' securities and offers of securities to the public;

The Rules governing the listing of securities on The Stock Exchange of Hong Kong Limited (Listing Rules) and the Rules governing the listing of securities on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited (GEM Rules)—All listed companies are required to comply with the Listing Rules or the GEM Rules. The Listing Rules and GEM Rules are the principal source of regulation relating to corporate governance of listed companies, irrespective of their place of incorporation; and

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<sup>79</sup> The Bermudan and the Cayman Islands company laws are based on the English common law. As such their company laws should provide similar levels of protection as that afforded under the Hong Kong Companies Ordinance. Companies incorporated in the People's Republic of China must comply with certain additional requirements under the Listing Rules. Companies incorporated in other jurisdictions have to demonstrate to the Stock Exchange of Hong Kong Limited that they are subject to appropriate standards of shareholder protection which are at least equivalent to those required under Hong Kong law.

The Codes on Takeovers and Mergers and Share Repurchases (the Takeovers Code)—The Takeovers Code applies to takeovers, mergers and share repurchases affecting public companies in Hong Kong, China and companies with a primary listing of their equity securities in Hong Kong, China.

### ***The Listing Rules***

The corporate governance requirements in the Listing Rules and GEM Rules are divided into:

- Listing Rules and GEM Rules that listed entities (issuers) must comply with; and
- The Code of Corporate Governance Practices (CG Code), divided into:
  - Principles;
  - Code Provisions (CPs) that issuers are expected to comply with but may choose to deviate from; and
  - Recommended Best Practices (RBPs) that are for guidance only;
  - An issuer must state whether it has complied with the CPs in the CG Code for the relevant accounting period in its interim report and annual report. Where an issuer has deviated from the CPs set out in the CG Code, it must give considered reasons. For annual reports, these reasons must be set out in the form of a Corporate Governance Report that is in accordance with Appendix 23 of the Listing Rules.

## **1.2 Trends**

The tables below show the number of companies that are listed on The Stock Exchange of Hong Kong Limited (Exchange) and the total market capitalization as at the end of each year from 2005 to 2009.

Number of Hong Kong listed companies 2005-2009

	Dec 2005	Dec 2006	Dec 2007	Dec 2008	Dec 2009
No. of Main Board listed companies	934	975	1,048	1,087	1,145
No. of GEM listed companies	201	198	193	174	174
Total no. of listed companies	1,135	1,173	1,241	1,261	1,319

Total Market Capitalisation of Hong Kong issuers 2005-2009

	Dec 2005	Dec 2006	Dec 2007	Dec 2008	Dec 2009
Market Capitalisation for Main Board (HK\$ billion)	8,113	13,249	20,536	10,254	17,769
Market Capitalisation for GEM (HK\$ billion)	67	89	161	45	105
Total Market Capitalisation (HK\$ billion)	8,180	13,338	20,697	10,229	17,874

## 2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules

### 2.1 Development of Corporate Governance Rules

#### ***Relevant Regulatory Bodies***

The principal regulator of Hong Kong, China's securities and futures markets is the Securities and Futures Commission (SFC). The SFC is responsible for administering the SFO, the ordinance governing the securities and futures markets in HKC and other statutory ordinances. Two of the regulatory objectives of the SFC are to:

- Maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry; and
- Provide protection for members of the public investing in or holding financial products.

Hong Kong Exchanges and Clearing Limited (HKEx) is regulated by the SFC. The Stock Exchange of Hong Kong (SEHK) is a wholly-owned subsidiary of HKEx. The SEHK is the frontline regulator of all listing related matters including corporate governance for issuers.

The SFC has a statutory duty to supervise, monitor and regulate the SEHK's performance of its listing-related functions and responsibilities. The staff of the SEHK and the SFC meet regularly to discuss listing-related matters. The SFC also conducts a periodic audit of the SEHK's performance in its regulation of listing-related matters.

The SEHK's Listing Committee is an independent body which administers the Listing Rules on matters that are of material significance for issuers, their directors and authorised representatives. Day-to-day administration of the Listing Rules is delegated to the SEHK's Listing Division. The work of the Listing Division is subject to review by the Listing Committee with the reservation of specific matters to the Listing Committee by the Listing Rules.

The Listing Division, guided by the Listing Committee, will review and from time to time propose amendments to the Exchange Listing Rules. The Listing Division will seek the SFC's policy advice and comments on any proposals for potential amendments to the Exchange Listing Rules.

The Listing Division will seek the endorsement of the Exchange Board for any final proposals as decided by the Listing Committee and submit them to the SFC for approval. Section 24 of the SFO requires the Exchange Listing Rules to be approved by the SFC.

#### ***Standing Committee on Company Law Reform (SCCLR)***

The SCCLR is a non-statutory advisory body formed in 1984 to review the CO on a regular basis to ensure that the company law meets with the changing needs of the local business environment. The Companies Registry provides secretarial support to the SCCLR. The SCCLR is one of the main proponents of reforms for modernizing the company law and upgrading its corporate governance regime.

As the Registrar of Companies is the administrator of, inter alia, the CO, the Companies Registry collaborates, from time to time, with the Financial Services and the Treasury Bureau of the government of the Hong Kong Special Administrative Region in implementing the SCCLR's recommendations by means of amendment bills. With a view to updating and

modernizing the CO, the government launched a comprehensive rewrite of the CO in mid-2006. The rewrite also covers amendments to the corporate governance rules.

## 2.2 Enforcement of Corporate Governance Rules

The SEHK works to both enforce the Listing Rules and promote compliance.

Potential rule breaches are uncovered through a range of activities, including primarily the Listing Division's surveillance activities and research and data analysis, and also from many sources including tip-offs and complaints received from the public and media commentary. Each year the SEHK makes enquiries and investigates several hundred potential rule breaches. Depending on the type of conduct involved the SEHK is able to deploy a variety of graduated responses for non-compliance.

Disciplinary sanctions are one of the regulatory responses available to the SEHK but they are not the only response available and it may be possible to address instances of non-compliance without resorting to disciplinary action. The SEHK also sends warning letters, caution letters and guidance letters where appropriate to deal with behaviour which is not sufficiently egregious to justify disciplinary action. Directions (hence not just sanctions) are also imposed in appropriate cases by the Listing Committee to improve or enhance future compliance with the Listing Rules, e.g. compliance review of the issuers' internal control systems; appointment of a compliance adviser for consultation on Listing Rules compliance; and training for directors who are made parties to the disciplinary action (see 3.1 below).

Other non-disciplinary measures available where the SEHK considers it necessary to take protective or remedial action include suspension or, in exceptional circumstances, delisting.

The SEHK may suspend trading in an issuer's securities where there is inadequate disclosure or an issuer fails to comply with the continuing obligations of listing in a manner severe enough to justify suspension.

### **Regulatory Enforcement Actions**

The table below shows the disciplinary cases in 2008 and 2009. These cases involved investigations of both the company and its directors.

Nature of alleged breach of the Listing Rules	2008 Cases	2009 Cases
Misstatement or misleading information in prospectus or announcement	2	2
Failure to publish annual accounts and interim accounts within prescribed deadlines	3	0
Failure to disclose price sensitive information, significant advances to entities or discloseable transactions	4	4
Failure to obtain shareholder approval for connected or other transactions	7	3
Failure to respond to enquiries	1	0
<b>TOTAL:</b>	<b>17</b>	<b>9</b>

The outcome for the vast majority of these 26 cases was a public sanction by the Listing Committee. A private sanction was given for one of these cases. When a public sanction is imposed, the Listing Committee may also impose a public sanction on the directors (Executive and Non-Executive) whom it found to be in breach of their Directors' Undertakings to procure the companies' compliance.

One of the objectives behind enforcement action is to improve corporate governance. The Main Board (MB) Listing Rules enforced by disciplinary action address strong corporate governance

concerns. This is particularly so for actions brought because of failure to obtain prior independent shareholder approval.

### ***De-listed Companies***

MB Listing Rule 13.24 requires an issuer to carry out a sufficient level of operations or have tangible assets of sufficient value or intangible assets for which sufficient value can be demonstrated to warrant the continued listing of the issuer's securities on the Exchange. If an issuer cannot meet these requirements, MB Listing Rule Practice Note 17 sets out the delisting procedures that the SEHK will follow to de-list the issuer.

The issuers that are required to follow these delisting procedures are often those that have suffered corporate governance failings. The table below shows the number of these de-listings in the last two years.

Year	De-listings under Practice Note 17
2008	7 [Main Board issuers: 4; and GEM issuers 3]
2009	1 [Main Board issuers: 1; GEM issuers: 0]
TOTAL	8 [Main Board issuers: 5; GEM issuers: 3]

## **2.3 Assessment of Corporate Governance Practices**

### ***Report on the Observance of Standards and Codes***

In 2002, HKC participated in the Financial Stability Assessment Programme (FSAP). As part of the FSAP assessment, HKC was also assessed on its observance of the OECD Principles of Corporate Governance. The table below shows the results of the assessment.

Observed	Largely observed	Partially observed	Materially observed	Not observed	Not applicable
4	13	4	2	0	0

### ***Review of compliance with the CG Code***

Since the SEHK introduced the CG Code in 2004 (the Code became effective in 2005), it has reviewed issuers' compliance with the Code and published the results of its review.

On 20 February 2009 the SEHK published its report on the findings from its third review of issuers' corporate governance practices on the HKEx website.

The review found that:

- All 1,213 issuers met the requirement to comply or explain, i.e. all issuers either said in their annual reports that they had complied with the 45 code provisions or explained their deviation from one or more code provisions;
- About 98% of the issuers (up from 96% in the second review) complied with at least 41 of the 45 code provisions;
- Same as the second review, larger issuers complied with more code provisions than smaller issuers (based on market capitalisation); and
- The recommended best practices on quarterly reporting continued to have the lowest compliance rate.

## 3. Awareness and Advocacy for Good Corporate Governance

### 3.1 Company Directors

The Hong Kong Institute of Directors (HKIoD) was incorporated in 1996. It is a non-statutory body representing professional directors working together to promote corporate governance and to contribute towards advancing the status of Hong Kong, China, both in China and internationally.

HKIoD currently has over 1,400 members, consisting of directors from listed, public and private companies and statutory/non-profit-distributing organisations. The profile of its membership can be found at <http://www.hkiod.com/profile.html>.

CG Code Provision A.5.1 states that every newly appointed director should receive a comprehensive, formal and tailored induction and subsequently such briefing and professional development as necessary. This is to ensure that the director is fully aware of his responsibilities under statute and common law, the Exchange Listing Rules, applicable legal requirements and other regulatory requirements and the business and governance policies of the issuer.

Listed issuers are given the following guidance as to recommended best practice:

Recommended Best Practice A.5.5—All directors should participate in a programme of continuous professional development to develop and refresh their knowledge and skills to help ensure that their contribution to the board remains informed and relevant. The issuer should be responsible for arranging and funding a suitable development programme.

#### ***Remedial training***

As part of a disciplinary action taken by the SEHK, a director may be required to take remedial training. For previous disciplinary cases, this has meant training on Listing Rule compliance and directors' duties to be given by the Hong Kong Institute of Directors, Hong Kong Institute of Chartered Secretaries or any other recognised professional organisation satisfactory to the Listing Committee and/or the Listing Division within a specified time period.

#### **Educational System**

Higher education institutions in HKC enjoy a high degree of autonomy in managing their internal affairs including academic development. That said, electives related to corporate governance are common in our institutions, notably MBA programmes.

Hong Kong, China's judges and judicial officers do receive training in corporate governance. The Judicial Studies Board, set up under the chairmanship of a Vice President of the Court of Appeal of the High Court, is responsible for arranging such training.

#### **Stock Exchange**

The SEHK will offer training on changes to the Listing rules to issuers but it is not compulsory for directors to attend. In 2009, the Exchange organised two series of seminars (14 sessions) on listing rule amendments and notifiable transactions, which attracted an overall attendance of 3,000 participants.

HKEx does not support, endorse or accredit anybody that provides directors' training. However, in the past, the SEHK has required directors to attend remedial training if they have found to have breached the Listing Rules.

In 2009 and up to mid-May 2010, the Listing Division ran an outreach programme with issuers and market practitioners to learn their needs and to facilitate mutual understanding of regulatory issues through continuing dialogue.

## **4. Recent Developments in Corporate Governance**

### **4.1 Corporate Governance Developments**

#### ***Listed Companies***

##### *Amendment to the Law*

The government supports the cultivation of a continuous disclosure culture among listed corporations. A way to achieve this is to oblige timely disclosure of price sensitive information (PSI) under the statute.

The government commenced on 29 March 2010 a three-month consultation on the proposed statutory codification of certain requirements to disclose PSI by listed corporations. The proposed statutory regime will specify the requirements clearly in the law, with safe harbours, to facilitate compliance; enhance the effectiveness of investigation and enforcement; and ensure that all suspected breaches would be dealt with independently via statutory proceedings.

Through continuous improvement of the regulatory regime in respect of listing, the government is enhancing market transparency and quality, and promoting good corporate governance in HKC.

##### *Changes to the Listing Rules*

Over the last three years the Exchange Listing Rules, including the CG Code have been amended. Changes include:

- Shortening the publication deadlines for annual and half-year results announcements, effective for accounting periods ending 30 June 2010;
- Making voting by poll mandatory on all resolutions at general meetings of issuers. In addition, CG Code Provision E.1.3 was introduced that requires an issuer to send a notice to shareholders for an annual general meeting at least 20 clear business days before the meeting and at least 10 clear business days for all other general meetings;
- Requiring updates of previously disclosed directors' information by way of announcements; and
- Extending the "black-out" periods set out in the Model Code.

##### *Corporate Governance Review*

The Listing Committee has formed a sub-Committee to review the CG Code. The objective is to make possible enhancements to the CG Code benchmarked against international standards.

##### *Consultation on Connected Transaction Rules*

On 2 October 2009, the SEHK published a consultation paper on proposed changes to its connected transaction rules. In SEHK's conclusions, it addressed issues about some specific connected transaction requirements that are burdensome, restrictive or have unintended effects. The Rule amendments became effective from 3 June 2010.

### ***Unlisted Companies***

In the course of the rewrite of the CO, the SCCLR has further explored a number of corporate governance issues. The key proposals of the SCCLR include:

- (a) codifying the standard of directors' duty of care, skill and diligence with a view to clarifying the duty under the law and providing guidance to directors;
- (b) restricting the appointment of corporate directors by requiring every private company to have at least one natural person as director so as to enhance transparency and accountability;
- (c) strengthening rules on fair dealings by directors and disclosure of material interests in transactions;
- (d) providing greater transparency and improving disclosure of company information, such as new requirements for a business review;
- (e) strengthening auditors' rights, such as providing auditors with a right to require information from a wider group of persons;
- (f) enhancing shareholders' engagement in the decision-making process, such as reducing the threshold requirement for shareholders to demand a poll from 10% to 5% of the total voting rights; and
- (g) fostering shareholder protection, such as introducing more effective rules to deal with directors' conflicts of interests and enabling shareholders of a company to commence a statutory derivative action on behalf of a related company.

The proposals will ensure greater transparency and accountability within the company's operations and greater opportunity for all shareholders to engage in company business in an informed way.

## **4.2 Enforcement of Corporate Governance Rules**

Shareholder remedies provisions were substantially revised by the Companies (Amendment) Ordinance 2004 with a view to enhancing legal remedies available to members of a company. One of the amendments that relates to the enforcement of corporate governance rules is the provision for a statutory derivative action (SDA) that may be taken on behalf of a company by a member of the company. Unlike some comparable jurisdictions, only members of the company (*vis-à-vis* members of a related company of the company) have standing under the CO to seek leave to commence a SDA. In other words, only "simple" derivative actions, as opposed to "multiple" derivative actions, can be brought under the SDA provisions.

However, in a recent case, *Waddington Ltd v Chan Chun Hoo and Others* (2008) 11 HKCFAR 370, the Court of Final Appeal (CFA) ruled that an action by a shareholder of a parent company on behalf of a subsidiary or second or lower tier subsidiary is maintainable under the common law.

The concerns of the CFA were discussed in the context of shareholders in a holding company taking action on behalf of a subsidiary or sub-subsidiary. However, the Administration is of the view that there is a strong argument for extending the CFA's reasoning to justify giving standing to members of related companies, since this situation concerns a wrongdoer controlling the corporate group to the detriment of a shareholder in the group.

The proposals on enabling multiple statutory derivative actions has been incorporated into a Companies (Amendment) Bill introduced into the LegCo in early 2010. The Bill was passed by the LegCo on 7 July 2010.

In addition to the company law, the securities regulations (the Securities and Futures Ordinance) have provisions for the securities regulator (the Securities and Futures Commission (SFC)) to take action against listed companies and their directors in cases where there has been oppression against the minority shareholders, fraud, misfeasance, defalcation and other misconduct perpetrated against minority shareholders. The SFC in recent years has taken a more robust enforcement approach leading to more prosecutions for corporate governance failures.

Prosecutions for CG	2004	2005	2006	2007	2008	2009
No. of successful legal actions in court*	1	1	3	0	1	7

\*Some of these cases took years to conclude particularly when there were numerous parties involved. The case is only determined to be completed on the date it is resolved against all parties.

For instance, the SFC successfully applied to the court to freeze the assets of a newly listed company when it transpired that the company may have made false or misleading statements in its prospectus thus inducing investors to subscribe for its shares.

The SFC also obtained a court order directing a company to take legal action against its directors for breaches of their fiduciary duties. In another couple of cases, the SFC obtained court orders to disqualify a number of directors of two companies for providing misleading information in their companies' documents.

### **Recent Disciplinary Cases involving breach of Main Board Listing Rules**

Three significant cases<sup>80</sup> involving a breach of Main Board Listing Rules regarding connected transactions or an advance to an entity resulted in a public sanction in 2009. The Listing Rules breached for these cases were: MB Listing Rules 13.13, 13.20, 14.34, 14.37, 14.38, 14A.45, 14A.47, 14A.52.

## **4.3 Current Issues and Challenges for Corporate Governance**

### **4.3.1 Challenges**

A few challenges are:

- Directors often do not see the benefits (e.g., higher share valuations and easier access to capital markets) out of improving their behavior. Education is needed.
- Even if they realize the benefits out of improving their behavior, they often focus on short term and not long term results. The rewards of good corporate governance are often long term.

There is always a group of constituents (e.g., start-ups, companies in financial difficulties) that do not have the resources to bring about better corporate governance.

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<sup>80</sup> These include: (i) Pearl Oriental Innovation Limited (23/03/2009): <http://www.hkexnews.hk/reports/enforcement/090323.htm>; (ii) China Solar Energy Holdings Limited (9/07/2009): <http://www.hkexnews.hk/reports/enforcement/090709.htm>, and (iii) Travelsky Technology Limited (28/09/2009): <http://www.hkexnews.hk/reports/enforcement/090928.htm>

### **4.3.2 Priorities for Reform**

As the CO is undergoing a comprehensive review and public consultation on the rewrite, one of the top priorities for corporate governance reform is the introduction of a strengthened legal and regulatory framework taking into account the public's views expressed in the consultation. An effective implementation of the corporate governance provisions is also a main concern. Therefore, education of the public including the companies, directors, shareholders and creditors about the corporate governance reforms under the rewrite is one of the top ranking priorities.

In addition, as stated under 6.1 above, the Listing Committee has recently formed a sub-committee to review the CG Code and corporate governance issues that have arisen in the course of the Listing Committee's administration of the Listing Rules in recent years.

### **4.3.3 Financial Crisis**

A summary of HKC's responses in financial services to the Global Financial Crisis is given below.

#### *Banking Sector*

The Hong Kong Monetary Authority (HKMA) has implemented a number of measures to help maintain the stability and confidence in the monetary and banking sectors, and facilitate banks to better perform their function of financial intermediation. For example,

HKMA introduced five temporary measures to provide liquidity assistance to licensed banks in Hong Kong. The measures involve expansion of the scope of eligible collateral for access to, and the duration of, liquidity assistance through the Discount Window, and conduct of foreign exchange swaps and term repos by HKMA. These measures were in place until the end of March 2009. Following a review, two of the measures, foreign exchange swaps and term repos, have been incorporated into the ongoing market operations while others were terminated on 31 March 2009 as planned.

On 9 October 2008, HKMA adjusted the formula in determining the Base Rate to further ease tensions in the money market. Prior to the adjustment, the Base Rate was set at the higher rate of: (a) 150 basis points above the prevailing US Fed Funds Target Rate (FFTR); or (b) the average of the five-day moving averages of the overnight and one-month HIBORs. After the adjustment, the HIBOR leg was removed and the spread of the Base Rate over the FFTR was reduced to 50 basis points. These changes effectively lowered the cost of discount window borrowing. At end March 2009, the HKMA, after a review, decided to maintain the smaller spread of 50 basis points, but restated the HIBOR leg so as to allow the functioning of the interest adjustment mechanism under the Currency Board system.

On 14 October 2008, the Financial Secretary announced two pre-emptive measures, namely, the use of Exchange Fund to provide full guarantee for deposits held with all authorized institutions in Hong Kong in accordance with the principles of the Deposit Protection Scheme, and the establishment of a Contingent Bank Capital Facility for the purpose of making available additional capital to locally incorporated licensed banks. These measures will be in force till end 2010. The HKMA, Bank Negara Malaysia and the Monetary Authority of Singapore formed a tripartite working group in July 2009 with a view to mapping out a coordinated strategy for the scheduled exit from the full deposit guarantee by the end of 2010 in their respective jurisdictions.

On 29 October 2008, HKMA issued a circular urging banks to be more accommodating in lending to SMEs within the bounds of prudent credit assessment.

On 19 November 2008, HKMA issued a circular on “Hong Kong Approach to Corporate Difficulties” to remind banks that when dealing with corporate borrowers in financial difficulties, banks should remain supportive and not hastily put them into receivership or issue writs demanding repayment if they have a reasonable chance of survival.

On 21 November 2008, HKMA announced a temporary measure about a flexible approach towards the premium on capital adequacy ratio of individual banks and introduced a new arrangement for the provision of liquidity to Hong Kong, China banks operating on the Mainland. Local authorised institutions (AIs) remained well capitalised without the need for HKMA to lower their minimum capital adequacy ratio requirements. In order to promote financial stability and support renminbi-denominated trade transactions between Hong Kong and the Mainland, the HKMA and the People’s Bank of China established a RMB-HK\$ currency swap agreement in January 2009. With the establishment of this currency swap arrangement, short-term liquidity support (up to RMB200 billion or HK\$227 billion) can be provided to the Mainland operations of Hong Kong banks and the Hong Kong operations of Mainland banks in case of need.

On 26 March 2009, the HKMA announced the strengthening of the lender of last resort (LOLR) framework by expanding the types of assets and facilities eligible for obtaining LOLR support. Specifically, foreign exchange swaps have been included among the basic instruments to be used by the HKMA to provide LOLR support, and the definition of eligible securities for repos has been expanded to include securities in foreign currencies with acceptable ratings.

After consulting the industry in late 2009, the HKMA is in the process of implementing in Hong Kong the enhancements to the Basel II capital framework issued by the BCBS in July 2009. Implementation of enhancements on capital and disclosure requirements (i.e., Pillars 1 and 3) will be effected through legislative process which is currently underway, and those on supervisory review process to strengthen risk management standards (i.e., Pillar 2) through an updated supervisory guideline issued on 4 June 2010.

The HKMA will shortly issue for industry consultation a draft guideline to implement the systems and controls standards set out in the latest BCBS Liquidity Sound Principles. The guideline takes account of results of a self-assessment by AIs to evaluate their compliance with the Sound Principles and the responses of banks selected subsequently for an information consultation on the draft guideline.

As a member of the Basel Committee, the HKMA has contributed to, and relayed local issues and concerns during, the development of the consultative proposals on new capital and liquidity standards released by the BCBS on 17 December 2009 to strengthen the resilience of the banking sector. Public consultation on the proposals ended on 16 April. The HKMA has provided further comments arising from its discussions with the banking sector and various stakeholders to the Committee. Meanwhile, the HKMA is participating in a comprehensive quantitative impact study (QIS) launched by the BCBS as an important part of the latter’s process for calibrating the standards. With a view to better understanding the likely impact of the standards on the local banking sector, and formulating an appropriate plan for implementing these standards in Hong Kong, the HKMA is also conducting its own QIS on a broader range of AIs.

The HKMA, as a member of the BCBS and its various sub-groups, has been actively participating in the BCBS’s development of proposals for further enhancing the capital and liquidity regimes and the resilience of the banking sector.

In the course of 2009 and 2010 so far, the HKMA has also issued new guidelines on “Counterparty Credit Risk Management” and “Internal Audit Function”. Guidelines under development/revision to reflect latest international standards and best practices include market risk management (new), valuation practices (new), general risk management controls (revised), strategic risk management (revised), and reputation risk management (revised).

### *Securities Sector*

The Securities and Futures Commission (SFC) has taken a number of measures to ensure the financial and operational integrity of licensed corporations, including stepping up market surveillance and more stress testing of the liquid capital level to assess their sensitivity to extreme market conditions. The Hong Kong Securities Clearing Company Limited also doubled the default fee for failed settlement of short selling transactions.

SFC has been closely monitoring short selling activities in the Hong Kong, China market, and has made the preparatory work to facilitate the introduction of market-wide control measures during contingencies or when there is evidence of abusive short selling activities. While the short selling regulations in Hong Kong, China are stricter than those in place in many of the overseas markets, SFC is working towards increasing short position transparency. Following market consultation, SFC intends to introduce a short position reporting regime, whereby short sellers will have to furnish weekly reports to the Securities and Futures Commission if their short position in shares reaches 0.02% of the issued share capital of that particular listed company or the value of the short position reach HK\$30 million, whichever is lower. SFC prepares to conduct a follow-up consultation on the proposed legislative amendments required to implement the reporting mechanism.

Pursuant to EU’s Regulation on Credit Rating Agencies, if credit ratings made by CRAs based in Hong Kong (currently Fitch, Moody’s and Standard & Poor’s) are to continue to be serviceable in the EU, it will be necessary for Hong Kong, China to develop a compatible regulatory regime and have it operational by 7 June 2011. Working with SFC the aim is to introduce the legislative amendments within the latter half of 2010 so that the new legislative framework can be in place before end January 2011.

### *Insurance*

It was reported in the press that the American International Group, Inc. (AIG) had been badly hit by more than US\$25 billion in write-downs on credit default swaps (CDS) it wrote to guarantee mortgage-linked securities against default. AIG’s shares have tumbled sharply since end 2007.

A revolving loan facility of up to US\$85 billion provided by the Federal Reserve Board (Fed) in September 2008 has relieved the short-term funding pressure faced by AIG and is seen as a gesture of support by the US government to its restructuring exercise. The Fed and the US Treasury announced in November 2008 a revised financial assistance programme for AIG replacing the previous package with a larger and longer term US\$152 billion program, including a US\$60 billion 5-year loan and US\$52.5 billion to buy up distressed securities.

AIG has two composite insurance subsidiaries and four wholly owned general insurance subsidiaries in Hong Kong, China.<sup>81</sup> In response to the crisis of AIG, Insurance Authority (IA)

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<sup>81</sup> The six subsidiaries include (i) American International Assurance Company (Bermuda) Limited, (ii) American International Assurance Company Limited, (iii) American Home Assurance Company, (iv) National Union Fire Insurance Company of Pittsburgh, Pa, (v) New Hampshire Insurance Company and (vi) AIG United Guaranty Insurance (Asia) Limited.

exercised statutory power to safeguard the interests of policyholders by requiring insurance subsidiaries of AIG operating in Hong Kong, China to seek prior approval on all transactions involving movement of assets or funds to related entities within the same group. In addition, IA had stepped up monitoring the financial and solvency position of all other authorized insurers in Hong Kong, China.

The IA sanctioned a corporate restructuring that grouped American International Assurance Company (Bermuda) Limited into a subsidiary of AIA(HK) with effect from 28 February 2009, which aimed to position AIA(HK) as an independent entity for public listing.

On 1 March 2010, AIG announced an agreement for the sale of the AIA Group Limited which holds AIA to Prudential plc for US\$35.5 billion. On 2 June 2010, AIG and Prudential plc separately announced that the aforesaid agreement has been terminated. The IA is closely monitoring the possible strategic options available to AIG for the disposal of AIA Group to repay its outstanding debt due under the Fed's credit facility.

In parallel, Hong Kong, China is preparing proposals for the proposed establishment of a Policyholders' Protection Fund in Hong Kong, China to improve market stability and to safeguard the interest of policyholders in the event of insolvency of an insurer. The plan is to consult Legislative Council Panel on Financial Affairs on the detailed proposals in Q4 2010.

#### *Mandatory Provident Fund (MPF)*

Exposure of MPF assets to products that might be affected in the recent financial turmoil was insignificant as compared with the total net asset value of the whole MPF System. In the event that an MPF approved trustee experiences financial difficulties or even closes down, the MPF scheme assets will be protected by the multilayered safety net of the MPF scheme. First, MPF scheme assets are segregated from the assets of the employers, trustees and other service providers. Furthermore, in addition to capital adequacy requirements, the MPF legislation requires the trustees to obtain indemnity insurance as a safety net for the MPF schemes. The insurance is used for compensating losses to scheme assets attributable to fraudulent or illegal acts committed by the trustees, service providers and others. Finally, the Mandatory Provident Fund Schemes Authority (MPFA) can apply to the court for the use of the Compensation Fund as a last resort to compensate scheme members.

In the unlikely event that an approved trustee is placed into liquidation, the MPFA would revoke the approval of the trustee and appoint another entity to replace the trustee concerned in order to maintain the normal operation of the MPF schemes as much as possible.

MPFA stepped up the supervision of MPF trustees by requiring them to increase reporting on operational matters and financial positions. The MPFA also requested the trustees to provide their contingency plans in case the business viability of their own or their related entities is in doubt.

MPFA is satisfied that the businesses of all MPF trustees are viable and their operations have not been affected to any material extent.

The MPF legislation set out stringent requirements on the permissibility of investments into which the MPF constituent funds may invest in order to reduce risk as far as possible for the protection of MPF scheme members' interests. The MPF legislation imposes an investment spread requirement to reduce risk and restricts MPF funds from carrying out relatively high-risk activities such as those relating to borrowing and leveraging. The MPFA ensures compliance with the investment regulations by the approved trustees of MPF schemes through

different means, including examining the statutory returns and reports, conducting on-site inspections and investigating into complaints received, etc. The investment of all the constituent funds is managed by investment managers who are authorized by SFC.

The MPFA will continue to monitor the investment compliance of MPF investment funds.

## Key Corporate Governance Rules and Practices in Hong Kong, China

### Rules Regarding Listed Companies

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for shareholders' meetings?	X		Schedule 1 to the Companies Ordinance (CO)(Cap.32)	Shareholders' rights to propose a resolution for shareholders' meeting are governed by issuers' articles of association. Schedule 1 to the CO sets out the model articles of association that companies can adopt.
			Rules of the Listing of Securities on the Stock Exchange of Hong Kong Ltd (MBLR) 13.70 Rules of the Listing of Securities on the Growth Enterprise Market (GEM LR) 17.46B	Under the Listing Rules, an issuer must publish an announcement or issue a supplementary circular upon receipt of a notice from a shareholder to propose a person for election as a director at the general meeting.
			Section 115A CO	Companies must circulate members' resolution to all members of the company.
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		CG Code Provision E.1.2	The CG Code Provision E.1.2 states that the chairman should attend the annual general meeting and arrange for the chairmen of the audit, remuneration and nomination committees to attend and be available to answer questions. The chairman of the independent board committee (if any) should also be available to answer questions at any general meeting to approve a connected transaction or any other transaction that is subject to independent shareholders' approval.  The SEHK's review of 2007 annual accounts found that about 93% of issuers comply with CG Code Provision E.1.2. This is a rise from 91.4% for the 2006 annual accounts review.
3. Must company transactions with its insiders be on a non-preferential basis?	X		MB LR 14A.11 MB LR 14A.18 MB LR 14A.31 GEM LR 20.11 GEM LR 20.18 GEM LR 20.31	All transactions with "connected persons" (as defined in the Listing Rules) are subject to the connected transaction rules. Connected transactions should be conducted on normal commercial terms. The SEHK will require that connected transactions and continuing connected transactions are made conditional on prior approval by shareholders of the listed issuer in a general meeting. A circular for the transaction must be dispatched to shareholders.  "Intra-group transactions" and "de minimis transactions" (as defined in the Listing Rules) are exempt from these requirements.
			Guidelines on Directors' Duties	Under common law, directors have a fiduciary duty to act in the best interests of the company and not to allow personal interests to conflict with the company's interests.
4. Is a super majority vote required for major company acts affecting shareholder rights?	X		MB LR 6.12(2) (3) GEM LR 9.20(2) (3) Appendix 13a and 13b, paragraph 2	An approval of withdrawal of listing must be given by at least 75% of the votes attaching to any class of listed securities held by holders voting at the meeting and not more than 10% of votes cast against.  An approval of variation of class rights must be given by members holding at least 75% of the votes attaching to that class.

Element	Yes	No	Source(s) of Rule	Comments
			Section 63A of the CO	Variation of rights attached to a class of shares requires approval by 75% of the shareholders in that class.
			Rule 2.10 of the Takeovers Code	Takeover and privatization of a public company by scheme of arrangement or capital reorganization must be approved by at least 75% of the votes attaching to the disinterested shares that are cast either in person or by proxy; and the number of votes cast against the resolution to approve the scheme or capital reorganization must not be more than 10% of the votes attaching to all disinterested shares.
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors? What percentage?	X		MB LR 3.10, GEM LR 5.05	Boards must have three independent non-executive directors (INED), at least one of which must have appropriate professional qualifications in accounting or related financial management expertise.
			CP RBP A.3.2	The CG Code (RBP) states that an issuer should appoint INEDs representing at least one-third of the board.
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?	X		<b>Internal and external audit</b> MB LR 3.21 & 3.22 GEM LR 5.28 & 5.29 CG Code Provisions C.3.1 to C.3.6 and RBP C.3.7	<p><b>Internal and external audit</b></p> <p>The audit committee must comprise non-executive directors only. The majority of the audit committee must be INEDs and must be chaired by an INED. The board of directors of the listed issuer must approve and provide written terms of reference for the audit committee which clearly establishes its authority and duties.</p> <p>The CG Code states that the terms of reference of the audit committee should include at least the following duties:</p> <p><u>External audit</u></p> <p>Primary responsibility for making recommendation to the board on the appointment, reappointment and removal of the external auditor, approve remuneration and terms of engagement for the external auditor and any questions of resignation or dismissal of that auditor;</p> <p>to review and monitor the external auditor's independence, objectivity and effectiveness of the audit process including discussion of the scope of the audit and reporting obligations;</p> <p>to develop and implement policy on the engagement of an external auditor to supply non-audit services; and</p> <p>to monitor integrity of financial statements of an issuer and the issuer's annual report and accounts, half-year report and, if prepared, quarterly reports.</p> <p>The audit committee must liaise with the issuer's board of directors and senior management and must meet at least once a year with the issuer's auditors.</p> <p><u>Internal audit</u></p> <p>The audit committee's duties also include:</p> <p>Reviewing the issuer's financial controls, internal control and risk management systems;</p> <p>ensure that management has discharged its duty to have an effective internal control system;</p> <p>consider any findings of major investigations of internal control matters as delegated by the board or on its own initiative; and</p> <p>where an internal audit function exists, to ensure coordination between the internal and external auditors, to ensure that the internal audit function is adequately resourced and has appropriate standing within the issuer and to review and monitor the effectiveness of the internal audit function.</p> <p>The Exchange's review of 2007 annual accounts found that, on average, 99.5% of issuers comply with CG Code Provisions C.3.1 to C.3.6. This is a rise from 99.1% for the 2006 annual accounts review.</p>

Element	Yes	No	Source(s) of Rule	Comments
			<b>Executive compensation</b> CG Code Provisions B.1.1 to B.1.5 and RBP's B.1.6 to B.1.8	<b>Executive compensation</b> The CG Code states that issuers should establish a remuneration committee that has a majority of INEDs as members. The Exchange's review of 2007 annual accounts found that, on average 97.9% of issuers comply with CG Code Provisions B.1.1 to B.1.5 This is a rise from 97.5% for the 2006 annual accounts review.
7. Do independent directors decide what information the board receives from management?	X		CG Code Provisions A.6.1 to A.6.3	The CG Code states that management has an obligation to supply the board and its committees with adequate information in a timely manner to enable it to make informed decisions.
			CG Code Provision A.1.7	The CG Code also states that issuers should have a procedure agreed by the board to enable directors to seek independent professional advice in appropriate circumstances at the issuer's expense.
8. Are the chairman of the board and CEO different persons in the majority of listed companies?	X		CG Code Provision A.2.1	The CG Code states that the roles of the chairman and CEO should be separate. The Exchange's review of 2007 and 2006 annual report and accounts both found that about 63% of issuers comply with CG Code Provision A.2.1 to separate the role of chairman and CEO.
9. Are all board members elected annually?		X	CG Code Provision A.4.2	The CG Code states that every director, including those appointed for a specific term, should be subject to retirement by rotation at least once every three years.
			Article 91 of Schedule 1 to the CO	One third of the board of directors should retire by rotation every year. The directors to retire in every year shall be those who have been longest in office since their last election.
10. Does the board oversee enforcement of a company code of conduct?	X		Note to LR3.25(1) and Preamble to CG Code	The Listing Rules and the CG Code state that issuers may devise their own code on corporate governance practices on such terms as they may consider appropriate.
			MB LR 3.17, 13.67 and Appendix 10	The Listing Rules require that every director comply with the Model Code, or the issuers' own code on no less exacting terms. The Model Code sets out the required standards against which directors must measure their conduct regarding transactions in securities in their own company.
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with International Financial Reporting Standards (IFRS)?	X		MB LR Appendix 16.2(6) GEM Listing Rule 18.04 & 18.05	All financial statements of a listed issuer must conform with either: Hong Kong Financial Reporting Standards; or IFRS. A MB overseas issuer that has a secondary listing on the Exchange may use US GAAP. A GEM issuer also listed on NYSE or NASDAQ may use US GAAP subject to various conditions.
12. Are the identities of the five largest shareholders disclosed?	X		MB LR Appendix 16.13(3) GEM LR 18.17B	A statement must be included in the annual accounts as at the balance sheet data showing the interests or short positions of every person, other than a director or chief executive of the listed issuer, in the shares and underlying shares of the listed issuer as recorded in the register required to be kept under section 336 of the SFO and the amount of such interests and short positions.
			Sections 310 and 336 of the SFO and Part XV of the SFO generally	Every person who holds 5% or more interest in shares of a listed corporation (notifiable interest) must disclose his interests by filling and submitting the relevant form to the Exchange and the listed issuer. He must also notify the listed issuer and Exchange of changes of more than a prescribed percentage to his interest. Every issuer must keep a register of interests in shares and short positions once it receives such notification of acquisition and changes in notifiable interest.
13. Is compensation of	X		MB LR Appendix	A listed issuer shall disclose in its financial statements

Element	Yes	No	Source(s) of Rule	Comments
company executive officers disclosed?			16.24 & 16.25 GEM LR 18.28 CG Code RBP B.1.7	information of directors' remuneration on a named basis and of the five highest paid individuals during the financial year. The CG Code recommends that issuers disclose details of any remuneration payable to members of senior management, on an individual and named basis, in their annual reports and accounts.
14. Are extraordinary corporate events disclosed?	X		MB LR 13.09 GEM LR 17.10	An issuer must publish as reasonably practicable any information relating to the group which is necessary to enable an appraisal of the position of the group, or is necessary to avoid the establishment of a false market in the group's securities or might reasonably expected materially to affect market activity in and the price of its securities.
			Chapter 14	Chapter 14 requires disclosure of notifiable transactions, including mergers and acquisitions.
15. Are risk factors disclosed in securities offering materials?	X		MB LR 19A.42 MB LR Appendix 1a.34(1)(b) MB LR Appendix 1b.29(1)(b) GEM LR Appendix 1a.66 & 67 GEM LR Appendix 1b.29(1)(b)	The contents of a listing document must include a statement as to the financial and trading prospects of the group for at least the current financial year, together with any material information which may be relevant thereto, including all special trade factors or risks (if any) which are not mentioned elsewhere in the listing document and which are unlikely to be known or anticipated by the general public, and which could materially affect the profits. Additionally, a risk factor section is required for PRC listing applicants
16. Are transactions of a company with its insiders disclosed?	X		MB LR 14A.11 MB LR 14A.18 MB LR 14A.31 GEM LR 20.11 GEM LR 20.18 GEM LR 20.31	All transactions with "connected persons" (as defined in the Listing Rules) are subject to the connected transaction rules. Connected transactions should be conducted on normal commercial terms. The Exchange will require that connected transactions and continuing connected transactions are made conditional on prior approval by shareholders of the listed issuer in a general meeting. A circular for the transaction must be dispatched to shareholders. "Intra-group transactions" and "de minimis transactions" (as defined in the Listing Rules) are exempt from these requirements.

Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory

## Rules Regarding Unlisted Companies

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for shareholders' meetings?	X		Section 116B CO	Members may propose a written resolution which directors are required to circulate to all members for unanimous approval.
			Section 113 CO	Members may requisition an extraordinary general meeting or may convene a meeting if the directors fail to do so.
			Section 115A CO	Members may request for circulation of a resolution intended to be moved at an annual general meeting.
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?				This may happen in practice. There are no specific provisions on this matter.
3. Must company transactions with its insiders be on a non-preferential basis?	X		Section 157H and 162 CO	There are various CO provisions which regulate a company's dealings with directors. For example, section 157H which prohibits a company from entering into any direct or indirect related party transactions with its directors and section 162 which requires disclosure by directors to the board of material interests in contracts with the company.
4. Is a super majority vote	X		Section 114(3)	Consent for calling a general meeting or AGM by shorter

Element	Yes	No	Source(s) of Rule	Comments
required for major company acts affecting shareholder rights?			CO	notice.
			Section 166 CO	Section 166 – approval for a compromise or arrangement with members.
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors? What percentage?		X		
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?				Not applicable.
7. Do independent directors decide what information the board receives from management?				Not applicable.
8. Are the chairman of the board and CEO different persons in the majority of listed companies?				Not applicable.
9. Are all board members elected annually?		X		The rotation and election of directors are usually provided for in a company's constitution.
10. Does the board oversee enforcement of a company code of conduct?				No specific provisions in the CO to so provide for.
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with International Financial Reporting Standards (IFRS)?		X	Section 123 and 126 CO	While company directors are required to give a true and fair view of the state of affairs and profit or loss of the company, there is no explicit provision in the CO which requires them to prepare accounts in compliance with the requirements of the HKFRSs (which have fully converged with IFRS since 1 January 2005) or IFRSs. However, under the Professional Accountants Ordinance, Cap. 50 of the laws of Hong Kong, certified public accountants (including auditors) are required to observe the Hong Kong Institute of Certified Public Accountants' (HKICPA) professional standards which include, inter alia, the HKFRSs.
			Section 141D CO	Eligible private companies with unanimous members' consent can prepare simplified financial and directors' reports based on the Small and Medium-sized Entities Financial Reporting Framework and Small and Medium-sized Entities Financial Reporting Standard issued by the HKICPA.
12. Are the identities of the five largest shareholders disclosed?	X			There is no such specific requirement but such information are available from the following sources:
			Section 95(1)(a), 96, 98 CO	The register or index of members of a company which gives particulars of the names of members and shares held is open to inspection by members and non-members.
			Section 107(2)(f), (g) CO	The particulars relating to members and share capital of a company are required to be given in the company's annual return which is required to be filed with the Registrar and is available for public inspection.
			Section 129A(1) CO	A subsidiary's accounts must contain in the notes or statement annexed to it the particulars of its ultimate parent undertaking.
13. Is compensation of company executive officers disclosed?	X		Section 161(1)(c), 161A, 161C CO	Compensation to directors for loss of office is required to be disclosed in the accounts or in a statement annexed to it.
14. Are extraordinary corporate events	X		Section 129D(3)(a),(l)	A directors' report is required to state any significant change in the principal activities of the company and its subsidiaries in

Element	Yes	No	Source(s) of Rule	Comments
disclosed?			CO	the course of the financial year and of particulars of matters so far as they are material for the appreciation of the state of the company's affairs (unless harmful to its business).
15. Are risk factors disclosed in securities offering materials?	X		Section 38 CO	Section 38 CO requires every prospectus issued by or on behalf of a company to state the specific matters and reports as listed in the Third Schedule to the CO which require, inter alia, that sufficient particulars and information should be set out in the prospectus to enable a reasonable person to form as a result thereof a valid and justifiable opinion of the shares or debentures and the financial condition and profitability of the company at the time of the issue of the prospectus.
16. Are transactions of a company with its insiders disclosed?	X		Section 161, 161A, 161C CO	Directors' emoluments and pensions are required to be disclosed in the accounts of the company or in a statement annexed to it.
			Section 161B, 161BA, 161BB, 161C CO	Loans, quasi-loans and credit transactions in favor of directors, managers and secretaries are required to be disclosed in the accounts of the company.
			Section 155B(1) CO	Notices of resolution are required to contain disclosure of directors' material interest in the matter dealt with by the resolution.
			Section 129D(3)(ia), (j), (k), 162A CO	The following information is required to be disclosed in a directors' report: The directors' material interests in any contract of significance in relation to the company's business with the company, its subsidiary or holding company or a subsidiary of the company's holding company. The management contracts entered into by the company and the name of any director interested therein. A statement explaining the effect of any arrangement whose objects are to enable directors to acquire benefits by means of share acquisition in, or debentures of, the company or any other body corporate, and the names of directors (and nominees) who acquired such debentures.
			Tenth Schedule para 9(1)(c), 47C(4)(b), (c) CO	Outstanding loans to employees for the purchase of shares in employee share schemes are required to be disclosed in the balance sheet of a company.

Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory

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# Indonesia

## Corporate Governance Institutions, Practices and Developments

### **1. Key Institutional Features of Corporate Governance and Company Profile in Indonesia**

Komite Nasional Kebijakan Corporate Governance (KNKCG), as stipulated in Decree of the Coordinating Minister for Economy, Finance and Industry No. KEP-31/M.EKUIIN/06/2000. The main task of KNKCG is formulating and proposing economy-wide policy recommendations on GCG, as well as to initiate and to oversee efforts to improve corporate governance in Indonesia. In 2001, KNKCG managed to publish General Guidelines on Good Corporate Governance (GCG) and revised on 2006, and in 2004 a CG Guidelines for Banking industry, as well as Guidelines on the effective appointment of Independent Commissioner and establishment of Audit Committee. In 2004, GoI enhanced the task and function of KNKCG through the issuance of Decree of Coordinating Minister on Economic Affairs No. KEP-49/M.EKON/II/TAHUN 2004 concerning The Establishment of National Committee on Governance Policy (KNKG). The decree states that the task of KNKG is not only to socialize the principles of GCG in corporate sector, but also in the public service sector.

Until recently Indonesia had two stock exchanges, the Jakarta Stock Exchange and the Surabaya Stock Exchange. The two merged in 2007, creating the Jakarta-based Indonesian Stock Exchange (IDX).

As in other emerging markets, the five years leading up to 2008 saw a boom in market prices and activity. From January 2005 to December 2007, the composite index of the IDX climbed by over 160%, and the number of listed companies grew from 330 to 383. The market then declined by over 50%, before recovering in 2009 by over 87% in the nine month period ending in July. However, despite its significant growth, Indonesia's equity market (and portfolio equity flows) remains relatively modest by international standards.

Indonesia has a modern shareholder recordkeeping system. All shares that are traded on the IDX must first be dematerialized and deposited in KSEI2. Only brokers and custodians have access to the system but the KSEI has also begun keeping track of sub-accounts at the customer level. Settlement is T+3.

There are about 335,000 accounts in KSEI. When mutual funds are included, many estimate that there are approximately two million shareholders in Indonesia.

Based on ownership data from scripless shares, the three largest shareholders control an average of 60.9% of listed companies. Listed companies can be generally broken down into five different categories (actual ownership patterns are not transparent and detailed data were not available for the report):

- **Groups.** The majority of listed companies are controlled by families or approximately 10 large family-owned company groups. The largest groups include Bari, Jolum, Lipo and Jardin.
- **State-owned enterprises.** The central government controls 114 companies through the Ministry of State-Owned Enterprises; 13 are listed on the ISX.
- **Banks.** There are 123 banks, of which 24 are listed (including all the large ones). The four state-owned banks (all listed) represent 35% of assets. According to Bank Indonesia, on average, 48% of bank assets are owned by foreigners.
- **Foreign controlled companies.**
- **Independent companies that are not part of groups**

## 2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules

### Development of Corporate Governance Rules

The company law framework is based on civil law. Key laws include the 2007 Company Law (Law 40/2007). Bapepam LK is the securities and non-bank finance regulator and has issued a number of corporate governance related regulations. Bank Indonesia, the central bank, has also issued corporate governance standards for banks. The National Commission on Governance (NCG) was established by Decree of the Coordinating Minister for Economy, Finance and Industry, and includes 30 representatives from the public and private sector. It works on both public and private sector governance and issued a Code of Good Corporate Governance (CGCG), most recently updated in 2006.

Bapepam has issued a variety of regulations for public companies. These cover typical securities market matters (prospectus and disclosure requirements, and takeover regulation) but also issues that are often part of company law (for example shareholder meeting requirements). In many cases the regulations duplicate certain CL provisions, allowing Bapepam to enforce these matters directly.

Bank Indonesia's (BI) 2006 corporate governance regulation applies to both listed and non-listed banks, and addresses the function and composition of the board of commissioners (BoC) and the board of directors (BoD); the establishment of risk management, audit, nomination and remuneration committees; internal and external audit, disclosure of financial information; and introduced a requirement for a corporate governance implementation report.

As well as government-initiated undertakings, there are several non-governmental organizations whose main purpose is to establish, monitor and improve the implementation of GCG principles, including the Forum for Corporate Governance in Indonesia, the Center for Good Corporate Governance, the Indonesian Institute for Corporate Directorship (IICD), the Indonesian Institute of Corporate Governance (IICG), *Ikatan Komite Audit Indonesia* (IKAI) and the Indonesian Society of Commissioners (ISICOM). In addition, the Indonesian Chamber of Commerce and Industry has drafted a roadmap of GCG implementation in Indonesia.

The role of the National Committee on Corporate Governance Policy (KNKCG) is to create a general code and sectoral codes, and publish best practices of corporate governance and technical guidelines:

- General code:
  - General Code of GCG, Published on 2001, and Revised on 2006
  - General Code of Good Public Governance (2008)
- Sectoral code:
  - Code of Good Corporate Governance for The Banking Industri (2004)
  - Code of Good Corporate Governance for The Insurance and Re-Insurance Company (2009)
  - Code of Good Corporate Governance for Aktuaris Consultant Company (2010)
- Technical Guideline:
  - Code of Independent Commissioners and Audit Committee (2004)
  - Whistle Blowing System (WBS)/Pedoman Pelaporan Pelanggaran
  - Best Practices : Code of Business Ethics (2010)

### **Enforcement of Corporate Governance Rules**

The enforcement of regulations for implementing GCG principles does not yet include effective sanctions, except in the banking sector and in capital markets, where the Capital Market and Financial Institutions Supervisory Body (Bapepam-LK) can impose sanctions for violations of administrative law or its implementing regulations committed by any party that has obtained a permit, approval or registration from Bapepam-LK. Sanctions imposed by Bapepam-LK can include: written warning, fines, cancellation of business activities, freezing of business activities, revocation of a business license, cancellation of the agreement and cancellation of registration.

Specifically as regards public listed companies, to enhance transparency and good corporate governance in public listed companies Bapepam-LK has issued Rule No. IX.I.5: Tentang Pembentukan Dan Pedoman Pelaksanaan Kerja Komite Audit (Setting up and Operating Guidelines of the Audit Committee), Lampiran Keputusan Ketua Bapepam-LK No. Kep-29/PM/2004 dated 24 September 2004. It is expressly provided therein that the Audit Committee which shall be set up by the BoC is to assist the BoC in discharging its duties and responsibility. Such Committee must be headed by the Independent Commissioner who must fulfill certain requirements laid down in detail in said Bapepam-LK Rule.

The Audit Committee shall consist of at least one Independent Commissioner and at least two other members from outside the public listed company. The said Bapepam-LK Rule further lists a number of specific requirements which must be fulfilled by the members of the Audit Committee.

In carrying out its duties the Audit Committee is entitled to have access to the company's records, assets, capital, manpower and other matters related to its function as the Audit Committee, including close cooperation with the company's internal audit.

The Audit Committee shall report to the BoC about each specific task given to it and shall once a year give an annual report of the way it has discharged its duties.

Likewise in the case of Indonesian commercial banks, including branches of foreign banks licensed to operate in Indonesia, Peraturan Bank Indonesia No. 8/4/PBI/2006 Tentang Pelaksanaan Good Corporate Governance provides that the BoC shall institute an audit

committee in the furtherance of an effective discharge of the Board's duties and responsibility. The structure and membership of the audit committee, and the duties and responsibility of its members are set forth in detail in the above-mentioned Bank Indonesia Regulation.

Bapepam-LK has continued to introduce and amend its regulations, and has actively enforced these regulations to better protect investors. In 2006, Bank Indonesia introduced rules for corporate governance in banks, and has actively monitored and enforced their implementation. The Code of Good Corporate Governance (CGCG), first adopted in 1999, was amended in 2006, and sector specific codes issued for Banking and Insurance. In 2007 a new Company Law was adopted that introduced explicit duties for board members. The Ministry of State-Owned Enterprises has also carried out significant corporate governance reform in the state-owned enterprise (SOE) sector.

- Keputusan Menteri Negara Pendayagunaan BUMN Nomor Kep-133/M-PBUMN/1999 tentang Pembentukan Komite Audit bagi BUMN.
- SE Ketua Bapepam Nomor Se-03/PM/2000 tentang Komite Audit yang berisi himbauan perlunya Komite Audit dimiliki oleh setiap Emiten.
- Peraturan Menteri BUMN Nomor PER-05/MBU/2008 Tentang Pedoman umum pelaksanaan Pengadaan Barang dan Jasa BUMN.
- Keputusan Menteri BUMN No. 09A/MBU/2005 Tentang Proses Penilaian Fit & Proper Test Calon Anggota Direksi BUMN.
- SE Menteri BUMN No. 106 Tahun 2000 dan Keputusan Menteri BUMN No. 23 Tahun 2000 - mengatur dan merumuskan pengembangan praktik good corporate governance dalam perusahaan perseroan.
- Disempurnakan dengan KEP-117/M-MBU/2002 tentang Keputusan Menteri BUMN Nomor Kep-117/M-MBU/2002 tentang Penerapan Praktek *Good Corporate Governance* Pada BUMN.
- Peraturan Bank Indonesia (PBI) No. 8/4/PBI/2006 tentang GCG yang dirubah dengan PBI No. 8/14/GCG/2006.
- PBI No.11/33/PBI/2009 tentang pelaksanaan GCG bagi bank umum syariah dan unit usaha syariah.

### **Assessment of Corporate Governance Practices**

Indonesia's corporate governance framework was assessed in 2004 by the World Bank, in cooperation with Bapepam-LK and the IMF, under the Reports on Observance of Standards and Codes (ROSC) for Corporate Governance (World Bank, 2004). This World Bank assessment is somewhat out of date, especially bearing in mind the enacting of the new Company Law in 2007. However, as it used the OECD Principles of Corporate Governance as the benchmark, it nevertheless provides a helpful reference. In 2009 this program was continued through the ROSC Financial Services Assessment Program (FSAP), which covers corporate governance practices in Indonesia.

Using the Assessment of the OECD Principles of Corporate Governance, Indonesia's scores have improved since the last ROSC was carried out in 2004. The biggest increases are in shareholder rights, where average implementation has increased from 56% to 76%, and disclosure, where implementation increased from 60% to 74%. Nevertheless, more work remains to be done. Using a new methodology to assess compliance with the OECD Principles only four Principles were fully observed, 29 were broadly observed, 27 Principles were

partially observed, and three were not observed. Compared to other economies in the region, Indonesia still lags in key areas, but is closing in on the regional standard-setters, particularly India, Thailand and Malaysia.

BI has developed a survey instrument to monitor the implementation of its regulation, and monitors the corporate governance reports that must be produced by banks. In general, these surveys indicate that governance performance significantly improved from 2008 relative to 2007, and state-owned banks appear to be doing better at complying with corporate governance regulations than smaller banks. In general, there appears to be a much higher level of understanding, more training, and better policies and procedures relative to five years ago.

### **3. Awareness and Advocacy for Good Corporate Governance**

#### **Company Directors**

Instituted for directors and commissioners by the Indonesian Commissioners and Directors Institute (*Lembaga Komisaris dan Direktur Indonesia*, LKDI). LKDI has 241 members drawn from directors and commissioners of SOEs and private-sector enterprises. LKDI, under the auspices of KNKG, has been promoting change agents in corporations that have consistently exercised GCG principles since 2001. Other educational institutes and training agencies also participate in the program. Directors and commissioners are not yet required to have GCG certification, but the government considers that there is a need to introduce such a requirement. The government intends to develop systems, structures and processes that will encourage improvements in corporate culture. As a longer term measure, the government intends to support the inclusion of modules on ethics and governance in basic education up to college level.

While not encouraged by the rule/law, the Indonesian Commissioners and Directors Institute and other institutions in Indonesia offer board member training, and hundreds of directors and commissioners have been participated in training programs. The law/rule does encourage some board evaluation, and many companies seem to have some evaluations for the BoC, though they disclose few details on the process.

#### **Stock Exchange**

IDX has continuously encouraged listed companies to enhance the quality of their GCG, through the transparency of the company's activities throughout the year reported in the company's annual report. The IDX in cooperation with the State Ministry of State-Owned Enterprises, Bank Indonesia, Bapepam-LK, Directorate General of Taxation, National Committee of Governance and Association of Indonesian Accountants held Annual Report Award (ARA), ARA is routine annual program. This year (2010) marked the Eighth ARA. The number of corporations competing for the award is growing, and the quality of the reports presented is also improving. The objective of the ARA is to improve the quality of corporate annual reports, with a focus on the reporting on implementation of good corporate governance. Adequate information about the implementation of good corporate governance enables investors to make better investment decisions and also improves the quality of the capital market in Indonesia. The commitment that listed companies showed towards the GCG values was reflected in the participation of 120 listed companies in the event (ARA).

In addition to this, in support of GCG and efforts to enhance the business world's awareness of the importance of GCG, the IDX and PT Ernst & Young Advisory Services (EY) carried out a survey to assess listed companies' GCG practices and Internal Control over Financial

Reporting */ICoFR*. The survey was carried out on the basis of the Indonesian Good Corporate Governance Guidelines issued by the KNKG, Bapepam Decree No. KEP-40/PM/2003 dated 23 December 2003, concerning the Director's Responsibility for the Company's Financial Statement, prevailing international practices, as well as standards determined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

## **Government**

The main activity that promotes the quality and implementation of corporate governance is the Annual Report Award, a collaborative activity conducted since 2002 by seven organizations (Bapepam, BI, the Indonesian Stock Exchange, the Tax Office, IAI, the SOEs Ministry and KNKG).

# **4. Corporate Governance and State-Owned and Family-Controlled Enterprises**

## **State-Owned Enterprises**

SOEs are required to comply with sectoral and technical regulations in exactly the same way as other companies. For example, SOEs not using state budget funds for the procurement of goods and services are exempt from government procurement procedures so that they can be more efficient and not lose business momentum. Indonesian Minister for State-Owned Enterprises Decree No. 117/M-MBU/2002 stipulates that all companies owned by the state have an obligation to use the Code of Good Corporate Governance as a basic operational guideline.

To improve SOE governance and performance, the MSOE has appointed more professional directors / commissioners, improved the design of annual performance contracts for managers and listing minority stakes in many companies. They have also pushed through other changes, for example, requiring Bank Mandiri to appoint five new directors to support an IPO in 2003.

More recently, MSOE has developed a scorecard for rating the governance of the companies in the portfolio and produces an annual report on the state of the portfolio.

The government has disseminated GCG information to all SOEs. The government periodically employs independent parties to monitor GCG implementation. SOE BoCs are supported by several committees, including an Audit Committee, a Risk Management Committee and a Committee on Remuneration and Nomination. The number of SOEs that have an independent commissioner is increasing.

## **Family-Controlled Enterprises**

Professionalism, succession planning, and communication among family members, are major CG issues in the way family-controlled corporations operate. Many Indonesian companies are family controlled. Weak rules on independence of non-executive directors, related party transactions and takeover protection for minority shareholders, suggest that many of them are still run for the benefit of their controlling shareholders. Insider trading and market manipulation are commonplace, surveillance and enforcement are weak and the legal process cumbersome.

Many family-controlled enterprises still consider the mandatory requirements as a burden and do not contribute significantly to the value maximization of the company. The government and market at large do not function optimally in giving incentives for company with GCG.

The majority of listed companies are controlled by families or approximately 10 large family-owned company groups.

The awareness is not yet there for family-controlled companies. This is the reason why awarding publicly listed companies with best GCG practices regularly is very important to encourage more listed companies to join the enforcement of GCG principles.

## 6. Recent Developments in Corporate Governance

### Enforcement of Corporate Governance Rules

All listed companies are required to produce annual reports with audited financial statements that include a balance sheet, income statement, and cash flow statement. Consolidation is required if a public company controls or has majority ownership in other companies. The great majority of listed companies produce annual reports on a timely basis and Bapepam regularly monitors and enforces compliance with basic disclosure requirements.

In addition to financial statements, the annual report must include a board report with statements on corporate governance and corporate social responsibility. While recent regulation requires disclosure of corporate governance policies and practices.

The annual report should include details on board members including qualifications, meeting attendance and independence. Board member remuneration and remuneration policy are also to be disclosed.

Other mandatory elements of non-financial reporting include ownership, related party transactions (RPTs), and risks and risk management. Shareholders owning 5% or more of shares and the holdings of board members are to be disclosed. Disclosure of indirect or ultimate shareholdings or control is not required. Because shareholder approval is required for certain transactions, RPTs are sometimes disclosed *ex-ante*. Economy-wide accounting standards also require *ex-post* disclosure in the annual report. A limited set of RPTs, included transactions between SOEs, do not have to be disclosed.

Under Bapepam regulation, companies are required to publicly disclose information that could materially impact stock prices within two days, though such information is rarely posted on company websites. Material information is not to be selectively disclosed to certain investors or others, and companies generally comply with this requirement.

### Corporate Governance in Action

In Indonesia the authorities have continued to make significant efforts to improve corporate governance and investor protection.

Since it was issued in 1999, the CGCG has been revised several times (most recently in 2006). In addition the NCG has developed a set of sector-specific codes, including the Banking Sector Code (2004) and the Insurance Sector Code (2009). The GCG Code is considered to be voluntary, “a reference point” for both regulators and “all companies in Indonesia”. In contrast to codes in many other economies, companies do not have to provide a report on whether or not they comply with certain provisions, and if not why not (i.e. “comply or explain”).

The CGCG has indirectly served as an important source of good practice; the regulatory authorities have adopted key provisions and thus made them mandatory. This approach does increase compliance with those provisions that have been adopted into law or regulation, but

also reduces flexibility for small companies and others that may have specific and legitimate corporate governance concerns.

A new Company Law (CL) was introduced in 2007. The new law introduced explicit duties for board members and included a number of other updates. The new CL also contains: new regulations on corporate social responsibility for companies; removal of the possibility for companies to have authorized capital in excess of issued capital; a new requirement for a “Shariah Supervisory Board” for companies organized under the principles of Islamic finance; increased capital requirements for a limited liability company all shares to be paid in full; allows companies to send electronic updates to the company registry; and allows shareholder meetings to be held through electronic means.

Bapepam has issued a variety of regulations for public companies. These cover typical securities market matters (prospectus and disclosure requirements, and takeover regulation) but also issues that are often part of company law (for example shareholder meeting requirements). In many cases the regulations duplicate certain CL provisions, allowing Bapepam to enforce these matters directly.

Bank Indonesia’s (BI) 2006 corporate governance regulation applies to both listed and non-listed banks, and addresses the function and composition of the BoC and the BoD; the establishment of risk management, audit, nomination and remuneration committees; internal and external audit, disclosure of financial information; and introduced a requirement for a corporate governance implementation report.

The authorities generally consult with stakeholders on regulatory changes. Bapepam’s rule-making process requires an adequate consultation period when seeking comments from the public, and that these comments and amendments be disclosed. Observers report that Bapepam’s performance in this area has significantly improved over time.

## **Current Issues and Challenges for Corporate Governance**

### ***Lessons Learned***

#### *Reforms to the legal and regulatory framework*

The disclosure of ownership is hampered by the lack of a requirement to disclose the “ultimate” shareholders—most disclosure is made at the level of direct shareholders (including custodians). This prevents shareholders and regulators from understanding the true picture of ownership and makes it much more difficult to detect a variety of possible conflicts of interest (especially the various forms of related party transactions).

Definitions of direct (nominal) ownership and ultimate (indirect/beneficial) ownership should be introduced into the law, probably in the capital markets law. The notion of “acting in concert” should also be introduced.

Companies should also be required to disclose all significant (5%) direct and controlling owners in the annual report.

- As part of the redrafting of rules related to the disclosure of ownership and control, issuers should also be required to disclose the voting rights of all classes of shares, any special voting rights for specific shareholders, cross-shareholding, company group structures, and the identity of the ultimate controlling shareholder.

- Bapepam should also review ownership disclosures and work with the private sector to publish a report on overall ownership and control of listed issuers.

Non-financial disclosure should be more effectively regulated and complied with more generally. This includes: board member remuneration, including individual pay, pay policy, and the link to long-term performance; and policies on risk management and conflict of interest.

#### *Reforms to build regulatory capacity*

Bapepam should develop a set of guidelines, an operations manual, and a training program for the oversight of disclosure and other key corporate governance topics, in order to strictly enforce existing and future regulation. The manual should include: (a) a description of why disclosure is so important, (b) a description of good practice in each area, and (c) clear guidelines on what types of disclosures and behaviors are not acceptable.

Topics should include at a minimum:

- Conduct of shareholder meetings
- The review and approval of significant/related party transactions.
- The disclosure of ownership and control.
- Interpretation of company corporate governance statements.

Bapepam should strive to improve its capacity to review financial statements, engage additional professionally qualified and experienced accountants, and train existing staff to further enhance the effectiveness of the financial statements reviewers in the Corporate Finance Bureau to detect sophisticated manipulations of accounting and financial reporting policies.

Bapepam should also seek to recruit other staff from the private sector; and its policies on remuneration and training should be reviewed to facilitate this. In addition, Bapepam should create a strong deterrent to fraudulent use of customer securities by vigorously taking action against brokers and other market intermediaries in the event it takes place.

#### *Current pre-emptive rights rules*

Under current law and regulation, there is no way to “waive” or “dis-apply” pre-emptive rights in the event of a capital increase. In most jurisdictions, pre-emptive rights can be waived with a supermajority (e.g., 75%) vote. This gives companies the flexibility to raise capital when necessary from a new investor. Bapepam should study the advantages (and risks to shareholders) of allowing pre-emptive rights to be waived in Indonesia.

While significant progress has been made with SOE governance, the Ministry of State-Owned Enterprises should consider an additional, focused diagnostic on SOEs that could be the basis for improving their overall ownership policy and improving corporate governance in specific SOEs.

#### **Challenges**

Indonesia is still facing several challenges in its efforts to improve corporate governance, notably in enhancing the capacity of its regulators and improving the protection of shareholders’ rights and board responsibilities in practice. There is a strong demand for deepening the dialogue between the OECD and Indonesia. A bilateral program on corporate governance is being explored.

Indonesia's scores have improved since the last Report on the Observance of Standard and Codes (ROSC) was carried out in 2004 by the OECD. The average percentage implementation in the shareholder rights chapter increased from 56% to 76%, and from 60% to 74% in the chapter on equitable treatment of shareholders. Disclosure implementation increased from 60% to 71%, and the implementation of board responsibilities increased from 60% to 66%.

Nevertheless, more work remains to be done. Using the new methodology to assess compliance with the OECD Principles, four Principles were fully observed, 29 were broadly observed, 27 principles were partially observed, and three were not observed.

Indonesia lags many economies in the region, but is gaining on the regional standard-setters. Across most of the aspects of good corporate governance as defined by the OECD Principles, Indonesia is now closing on several economies (India, Thailand and Malaysia).

### ***Financial Crisis***

The full impact of the financial crisis in the US that had been triggered by the subprime mortgage crisis, could not be adequately foreseen. In September 2008, the effects of the crisis would broaden with the closure of a number of world-class financial institutions. The Dow Jones index reached its lowest point in the last seven years. This would cause a dramatic decline of share price indexes for all of the world's major stock markets including the IDX Composite Index.

The IDX Composite Index declined sharply on 8 October 2008 causing the market to panic. To address this situation and to prevent investors from taking hasty decision, the IDX took swift and effective action halting all trading activity at the Stock Exchange from 8-10 October 2008. Other key measures taken included reductions to share price auto rejection limits and the restriction of short-selling activities.

Throughout the suspension of trading activities, the IDX updated investors and other parties regarding the state of the market. As a result the IDX was able to secure the market, providing investors with sufficient time to make rational decisions.

The strategic steps taken by the IDX allowed it to mitigate the crisis. These measures received the full support of key stakeholders. Through intensive coordination with the government, Indonesian Capital Market and Financial Institutions Supervisory Agency (Bapepam-LK) and other authorities, the IDX has effectively maintained public trust in Indonesia's capital market.

The course of action taken by the IDX during this critical period has been commended. Successful implementation of its strategy was reflected by improving conditions by the end of the year. The Composite index as of year-end 2008 closed at a position of 1,355, an increase of 22% compared to the lowest position recorded in October 2008. The volume of foreign shareholdings has also registered an increase, up 26.7% from 422.39 billion sheets in December 2007 to 535.28 billion sheets in December 2008. This clearly indicates that in spite of the unstable conditions of the Capital Market in 2008, investors have not lost their trust in Indonesia's Capital Market.

To be responsive to the concerns of listed companies during the current global crisis, Bapepam has tried to be flexible and has adjusted some corporate governance-related rules and regulations (including those related to share buy backs and shareholder meetings).

## Key Corporate Governance Rules and Practices in Indonesia

Element	Yes	No	Source/Rule	Comments
<b>RIGHT OF SHAREHOLDERS</b>				
Do shareholders add items to the agenda for shareholders' meetings?	Yes		Company Law No. 40 Tahun 2007	Shareholders have the right to use the GSM to obtain information. Companies must create a list of shareholders in accordance with regulations. They must provide all information relating to the company, excluding genuinely confidential information—to shareholders on a timely and regular basis. This information must be provided to all shareholders regardless of the type of shares owned. Companies must provide accurate information on the conduct of the GSM. Shareholder rights are also protected by a Bapepam rule stating that the Audit Committee chairman shall be an independent commissioner.
Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	Yes			
Must company transactions with its insiders be on a non-preferential basis?	Yes			Every public company or issuer is required to submit an annual financial report to Bapepam including the balance sheet, profit and loss account, changes in equity holding, cash flow statement and other required financial reports. Every issuer must submit information to Bapepam if it conducts a transaction containing any conflict of interest or if it conducts a material transaction that changes its business.
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
Must boards have independent directors?		No	Company Law No. 40 Tahun 2007	<p>Indonesian companies have a two-tier board structure: a board of commissioners (BoC) and a board of directors (BoD). The BOC is supposed to oversee and advise the BoD, which in turn carries out the day-to-day operations of the company. Beyond these general mandates, there are few explicit responsibilities for the two boards in the law.</p> <p>The UUPT provides that the duty of the BoC (Board of Commissioners) is to supervise the policy of the BoD in managing the company and to advise the BoD.</p> <p>The BoD is the board which looks after the interest of the PT as an independent subject at law. The PT is the reason for the existence of the Direksi, therefore the Direksi owes its allegiance to the PT alone and not to individual shareholders. The Direksi is the representative of the PT as a <i>persona standi in iudicio</i> (independent subject at law) (Article 1 item 5 jis. Articles 92(1), 97(1) and 98(1)).</p> <p>Management of the PT as provided in Article 90 (2) means that the Direksi is charged with the duty:</p> <ul style="list-style-type: none"> <li>• to organize and execute the business activities of the PT;</li> <li>• to administer the assets of the PT; and</li> <li>• to represent the PT inside and outside the courts of law.</li> </ul> <p>The BoC is an independent supervisory body unknown to the common law. Albeit the Anglo-American Board of Directors may be divided in executive/managing directors and non-executive/non-managing directors, such board of directors is essentially different from the BoC as it is the executive organ of an Anglo-American corporation/company.</p> <p>The BoC is a mandatory organ of the PT charged with the duty to supervise the way the Direksi is discharging its management duties and to give advice to the BoD (Article 1 item 6 jo. Article 108(1) and (2)).</p> <p>The members of the BoC are not representatives of the shareholders. They are to exercise their supervisory duties in the interest of the PT. For this purpose the BoC has preventive powers where the Articles of Association require prior approval for certain acts of the Direksi (Article 117) and repressive powers where the Dewan Komisaris can suspend from office any members of the Direksi (Article 106).</p> <p>It should, however, be noted that the Direksi is not subordinated to the BoC, there is no hierarchy between the two organs.</p> <p>The responsibility of the BoC can be said to be substantially the</p>
Do independent directors oversee (i) internal and external audit and (ii) executive compensation?				
Does an independent director decide what information the board receives from management?				
Are the chairman of the board and chief executive officer different persons in the majority of listed companies?				

Element	Yes	No	Source/Rule	Comments
				<p>same as that of the Direksi.</p> <p>In connection with such responsibility one has to distinguish between internal liability and external liability.</p> <p>Internal liability refers to liability of the BoC to the PT for the proper discharge of its supervisory responsibility (Article 114).</p> <p>As regards external liability for loss suffered by third parties as e.g. in the case where the BoC had given its approval as required by the Articles of Association, knowing that the PT was not in the position to perform its obligations under the contract at hand, such external liability is expressly provided in Article 115 whenever the PT is adjudicated bankrupt due to the fault or negligence of the BoC. Said liability survives the termination of office of any members of the BoC for five years after such termination.</p>
Are all board members elected annually?	Yes			
Does the board oversee enforcement of a company code of conduct?	Yes			
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
Is the identity of the five largest shareholders disclosed?	Yes		Company Law No.40 Tahun 2007.	<p>The Bapepam Regulation on disclosure requires every public company or issuer to submit to Bapepam-LK all information or material facts that may affect the value of issued stock and the investment decisions of investors. Information includes good corporate governance practices, the remuneration of directors and commissioners, a description of the company's internal control and audit system, details of the risks and risk management efforts, and the CSR activities related to the community and the environment. Such information must also be publicly disclosed not later than two working days after the IPO proposal is approved.</p> <p>The continuation of the life of the PT requires the GMS as the organ (Article 1 item 2 jo. article 75) at which the owners of the PT's shares are able and fully authorized to decide to whom the Management of the PT they wish to entrust namely the Direksi (Article 1 item 5 jis Articles 92 and 97) and to whom supervision of the way such management is to be carried out namely the Dewan Komisaris (Article 1 item 6 jis Articles 108 and 114).</p> <p>It therefore can be said that decisions concerning the organizational structure of the PT (e.g. amendments of the Articles of Association, merger, amalgamation, division, acquisition, dissolution and liquidation, and bankruptcy), the rights and obligations of the shareholders, issuance of new shares, and appropriation of the annual profit made by the PT belong to the authority of the GMS.</p> <p>On the other hand, all that pertains to the business organization of the PT which are needed to achieve the PT's objects fall within the jurisdiction of the Direksi and Dewan Komisaris. Thus the appointment and dismissal of employees, to open branch offices and to perform any activities with regard to the organization of the PT as a business entity belong to the authority of the Direksi and Dewan Komisaris.</p> <p>This clear and distinct separation between shareholders' function (ownership of shares) and management (power) is the distinctive character of the PT and essentially differentiates it from the limited and unlimited partnerships.</p>
Is compensation of company executive officers disclosed?	Yes		Bapepam Regulation	
Are extraordinary corporate events disclosed?	Yes			
Are risk factors disclosed in securities offering materials?	Yes			
Are transactions of a company with its insiders disclosed?	Yes			

# Japan

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in Japan

#### 1.1 Background

##### *Companies law*

The Companies Law allows a company to adopt a variety of organization structures, including a board structure, in accordance with the size of the company and other factors. However, listed companies can adopt only one of two legal forms: the “Company with Statutory Auditors” model<sup>82</sup> and the “Company with Committees” model.

##### *“Company with Statutory Auditors” model*

In the “Company with Statutory Auditors” model, functional power rests with the board of directors, who execute and manage the business of the company as well as supervising and monitoring themselves and other executives and employees. Where this model is adopted, there are statutory auditors (Kansayaku) who form a separate organ of the company. The Kansayaku supervise the management by directors and owe the same fiduciary duties that directors do. The role of the Kansayaku is to ensure the legal validity of the actions taken by the board of directors. When they believe that the board of the directors has acted illegally, they can take legal action on behalf of the company.

Since related legislation went into effect in 1993, a “large company”, defined as one with at least 500 million yen in paid-in capital or 20 billion yen in debt, is required to have at least three Kansayaku, including one from “outside” the company. For this purpose, “outside” means not a current or former executive or employee of the company or a subsidiary within five years before becoming a Kansayaku.

In 2001, Japan introduced a requirement for at least half of a large company’s Kansayaku to be from “outside” the company. The definition of “outside” was also amended by this legislation. Under this legislation, which came into effect in 2005, “outside” is defined to mean not a current or former executive or employee of the company or an employee or executive officer of a subsidiary. This requirement has been retained in the new Companies Law established in 2005 (implemented in 2006).

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<sup>82</sup> This model includes “the ‘Company with a Board of Statutory Auditors’ model for the purpose of this memorandum”. Most listed companies adopting “Company with Statutory Auditors” model adopt the “Company with a Board of Statutory Auditors” version thereof.

### ***“Company with Committees” model***

The second form is called the “Company with Committees”, allowed under the 2002 legislation. Where this form is adopted, the company must establish three committees (compensation, audit and nominating committees), with each committee composed of three or more committee members appointed from among the directors. The majority of each committee’s members are required to be outside directors.

### ***Securities law***

The Financial System Council’s (FSC) Study Group on the Internationalization of Japanese Financial and Capital Markets published a report on 17 June 2009. On the basis of this report, a Cabinet Office regulation incorporated the following measures:

- Make registration of Corporate Governance structure, disclosure of executive compensation of 100 million yen or more, etc. on the security registration statement mandatory
- Make the submission of extraordinary reports regarding items discussed at the shareholders’ meeting mandatory

### ***Stock exchange listing requirements, voluntary codes***

The report mentioned above included various proposals for stronger corporate governance of listed companies. Also, the Tokyo Stock Exchange (TSE) has an Advisory Group on Improvements to TSE Listing System, which meets when appropriate and discusses corporate governance-related problems. The TSE implemented necessary revisions to its regulations in response to the report and the following discussion at the Advisory Group, such as its Securities Listing Regulations and Related Rules. TSE revised its rules as follows:

- Revised regulations on third-party share issues and combined reverse stock-splits (implemented on 24 August 2009)
- Revised regulations governing the structure of boards, strengthening of the function of statutory auditors and selection of independent directors or statutory auditors, etc. (implemented on 30 December 2009)
- Required disclosure of ballot results at shareholder meetings (implemented on 30 December 2009)

## **1.2 Trends**

TSE listed companies and market capitalization (as of the end of year) are indicated below.

	2005	2006	2007	2008	2009
Number of companies	2,351	2,416	2,414	2,389	2,334
Market capitalization (JPY 100 billion)	540	550	484	283	308

As can be seen from the above statistics, the number of listed companies was largely unchanged over the last five years. TSE Market capitalization fell following the financial and economic crisis in 2008. The stock market has been on an increasing trend with the recovery of the world economy, but it has not returned to its pre-crisis levels.

## **1.3 Key Corporate Governance Rules and Practices**

See Key Corporate Governance Rules and Practices in Japan, p. 118.

## **2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules**

### **2.1 Development of Corporate Governance Rules**

The Ministry of Justice (MOJ) is in charge of planning legislation regarding the Companies Law and related MOJ administrative regulations.

The Financial Services Agency (FSA), the FSC and Financial Products Exchange contribute to the development of corporate governance rules. First, the FSC's Study Group on the Internationalization of Japanese Financial and Capital Markets has published various proposals to strengthen corporate governance in listed companies. Also, the TSE convenes the Advisory Group on Improvements to the TSE Listing System when appropriate and discusses corporate governance-related problems. It also set up the Code of corporate conduct for listed companies, such as the Securities Listing Regulations and Related Rules, to protect shareholders and investors as well as to promote sound market management. Revising TSE regulations requires permission or notification from the FSA.

Ministry of Economy, Trade and Industry (METI) contributes to the development of Corporate Governance.

The METI Corporate Governance Study Group compiled a report in June 2009 and concluded in the report that, as a minimum, a listed company should have one "independent" director or Kansayaku who is not at risk of having conflicts of interest with ordinary shareholders in order to protect minority shareholders' interests. On the basis of this recommendation, the TSE revised its listing rules in December 2009.

### **2.2 Enforcement of Corporate Governance Rules**

Corporate governance rules may be enforced by the FSA, shareholder lawsuits, or TSE in various ways typical in developed economies. Statistics on these enforcement actions and lawsuits are not available at this time.

### **2.3 Assessment of Corporate Governance Practices**

Japan has not undertaken a formal self-assessment or conducted a Report on the Observance of Standards and Codes (ROSC) regarding the OECD Principles of Corporate Governance.

## **3. Awareness and Advocacy for Good Corporate Governance**

### **3.1 Company Directors**

There may be one or more private associations of company directors. However, the MOJ does not have any relationship with any such organizations.

The TSE does not provide any educational programs for company directors. However, the TSE holds open seminars on corporate governance when appropriate.

### **3.2 Media**

Japan's financial press regularly covers related developments and does not evidence a need for special education to do so responsibly.

### **3.3 Educational System**

The importance of corporate governance is widely acknowledged, and an increasing number of education institutions offer programs on corporate governance.

Also, the Legal Training and Research Institute of Japan, taking charge of training for judges, invites experts and provides lectures and joint studies regarding corporate governance. They cover broad themes, such as companies, employment, finance, and economics. Besides these programs, the Institute has curricula on leadership theory and management theory, where corporate governance is included.

### **3.4 Stock Exchange**

The TSE does not provide any educational programs limited to company directors only. However, the TSE does hold open seminars regarding corporate governance when appropriate.

## **4. Corporate Governance of State-Owned and Family-Controlled Enterprises**

### **4.1 State-Owned Enterprises**

The FSC's Study Group on the Internationalization of Japanese Financial and Capital Markets has made various proposals in a report to strengthen corporate governance in listed companies (June 2009). The report made proposals about the development of market rules as follows:

- Issues concerning capital management
- Structural aspects of corporate governance
- Issues surrounding shareholders' voting rights

### **4.2 Family-Controlled Enterprises**

In Japan, competitive capital markets and product markets ensure that any listed family-controlled corporations will make management decisions subject to the same pressures as other companies.

Family-owned enterprises do not all consider corporate governance requirements a disincentive to becoming listed companies.

## **5. The Role of Professional Service Providers in Corporate Governance**

Under the Companies Law, certified public accountants or accounting firms can be appointed as an accounting auditor of the company. An accounting auditor conducts an accounting audit of the company and provides an accounting audit report to the company. The accounting audit report is provided to the shareholders with their invitation to participate in the annual shareholders' meeting. Also, shareholders and creditors of the company can inspect and request copies of the accounting audit report at the head office of the company where the accounting audit report is kept.

The Financial Instruments and Exchange Act stipulates that financial statements have to be accompanied by an audit contract from a certified public accountant or accounting firm with no specific relations with the company.

Considering the international trend toward the introduction and strengthening of rating agency regulations, it is important that necessary regulation and supervision is secured to ensure ratings by those agencies do not mislead investors. On the other hand, it is also important that rating agencies can perform their necessary function in capital markets.

## **6. Recent Developments in Corporate Governance**

### **6.1 Corporate Governance Developments**

The FSA revised its regulations regarding disclosure, the TSE revised its listing rules, and the association of institutional investors established voluntary rules regarding the following measures:

- Strengthening TSE examinations disclosure regarding third-party share issuances, squeeze-outs, governance of group companies and cross-shareholdings
- The structure of boards of directors (proposal for three models for boards of directors and disclosure of the governance structure and reasons for adopting it), strengthening the function of statutory auditors (Kansayaku) (maintenance of adequate human resources, appointment of highly independent outside directors or Kansayaku, appointment of Kansayaku with an in-depth knowledge of finance and accounting, disclosure of companies' actions), selection of one or more independent directors or Kansayaku, enhancement of the disclosure of Kansayaku compensation
- Strengthening disclosure of the results of shareholder votes by institutional investors and the disclosure by listed companies of ballot results at shareholder meetings

Also, Cabinet Office regulations provide for the following measures:

- Require disclosure of Corporate Governance structure and executive compensation exceeding 100 million yen per annum, etc., on security registration statements
- Require submission of extraordinary reports regarding items discussed at shareholders meetings

### **6.2 Enforcement of Corporate Governance Rules**

One significant recent case of enforcement of corporate governance rules is a shareholders derivative lawsuit: Shareholders vs. directors and statutory auditors (Kansayaku) of Daiwa Bank Co., Ltd (Judgment, Osaka District Court, 20 September 2002). The matters at issue are:

- Whether directors and statutory auditors (Kansayaku) in question were liable for damages and losses invoked by the breach of duty to build up internal control system of the company?
- Whether directors in question were liable for damages and losses invoked by the breach of duty of compliance, including duty to have foreign branches to comply with foreign law?

The court held that, considering the facts in this case, certain directors of the particular business in question were liable for the damages and losses invoked by the breach of duty to build up proper internal control system and duty of compliance, while it held that the other directors and statutory auditors were not liable. The amounts of damages and losses held by the court that each director was liable for varied from US\$70 million to US\$775 million depending on the role and position of each director.

There are several cases which affirmed directors' liability for damages and losses invoked by the breach of duty of due care of prudent managers.

The derivative lawsuit of Duskin Co., Ltd (Judgment, Osaka High Court, 9 June 2006) is the case which affirmed the liability of statutory auditors (Kansayaku). In this case, the court ordered the statutory auditor (Kansayaku) to pay 211 million yen to Duskin Co., Ltd

## 6.3 Current Issues and Challenges for Corporate Governance

### 6.3.1 Challenges

Japanese companies have, on the whole, excellent corporate governance and do not face any of the challenges listed above to an extent more significant than other economies. Japan's past reforms have made their shareholders very active in corporate governance, applied competitive pressures to motivate boards to work harder, promoted domestic and international competition among companies, and enacted a legal principle of equality among all shareholders.

### 6.3.2 Priorities for Reform

Japan's system for corporate governance is of very high quality; however, we remain open to any future reform efforts backed up by solid research showing their potential for positive impact.

### 6.3.3 Financial Crisis

Japan's companies were comparatively better managed in terms of exposure to the junk bonds at the root of the crisis than the rest of the developed world during the years preceding the financial crisis, so except for secondary effects resulting from the drop in demand from other economies, they were able to emerge comparatively unscathed. In that context, reform measures would not be appropriate in Japan.

## Key Corporate Governance Rules and Practices in Japan

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for shareholders' meetings?	X		CL	Shareholders have the right to add items to the agenda for shareholders' meetings under the Companies Law.
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		CL	The directors of the company, in principle, have a duty to explain in response to shareholders questions asked at shareholders' meetings.
3. Must company transactions with its insiders be on a non-preferential basis?	X		CL	Although there are no regulations that state specifically that the transaction between a company and its insiders to be made on a non-preferential basis, the following provisions under the Companies Law have equivalent legal effect:  If a director of a company wants to make a conflict-of-interest transaction with the company, they are required to get approval from the board of directors. Any director who engages in such transactions and all directors who vote to approve such transactions shall be, in principle, liable for any damages resulting from such transactions.  In addition, transactions made between a company and its insiders on a preferential basis shall be disclosed in the financial statements of the company.
4. Is a super majority vote	X		CL	A super majority is required at shareholders' meetings

Element	Yes	No	Source(s) of Rule	Comments
required for major company acts affecting shareholder rights?				approving major company acts affecting shareholders' rights such as merger under the Companies Law.
Composition and Role of Boards of Directors and company auditors (Kansayaku) <sup>83</sup>				
5. Must boards have independent directors? What percentage?	X		CL	<p>If a listed company adopts the model of the Company with Committees, each committee shall draw at least a majority of its members from "outside" directors.</p> <p>On the other hand, "outside" directors are not required for the board of directors of a Company with Statutory Auditors. However, in the large companies which adopt the model of the Company with Statutory Auditors, half or more "outside" Kansayaku are required within their Kansayaku. As Kansayaku have right to attend board meetings and address the board when necessary under the Companies Law, it can also be said that the outside "board" members are required at the Companies with Statutory Auditors.</p>
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?	X		CL	<p>(i) Internal audits are conducted by the management of the company. Actions taken by the management are subject to audit by the Kansayaku (in the Company with Statutory Auditor) or audit committee (in the Company with Committees). As mentioned above, both Kansayaku and audit committees have "outside" Kansayaku or "outside" directors among their members. Through this, independent directors or Kansayaku have significant influence over internal audits.</p> <p>(ii) External audits are made solely by the accounting auditor of the company. Kansayaku and the audit committee shall review the audit methods taken by the accounting auditor.</p> <p>(iii) In a Company with Statutory Auditor, a resolution at a shareholders' meeting is required to determine the amount of executive compensation, and this resolution is legally binding. Kansayaku must review the agenda of the shareholders' meeting. In this way, Kansayaku (including "outside" Kansayaku) oversee executive compensation.</p> <p>In the Company with Committees, executive compensation is determined by the compensation committee. Therefore, outside directors within the committee oversee executive compensation.</p>
7. Do independent directors decide what information the board receives from management?	X			Directors and statutory auditors have the right to conduct investigations and request injunctions of illegal acts, as touched upon above.
8. Are the chairman of the board and chief executive officer different persons in the majority of listed companies?	X			Given the variety of organizational structures available to Japanese corporations, the narrow terminology of this question renders it impossible to answer with certainty. However, as all of these corporate forms provide for a large number of individuals with significant authority over actions in listed companies, this is more true than not.
9. Are all board members elected annually?		X	CL	Directors' terms in public companies continues until the end of the annual shareholders' meeting for the last business year which ends within two years from their election in principle. The term can be shortened by the articles of incorporation but cannot be extended in public companies.
10. Does the board oversee enforcement of a	X			Japanese companies may have various codes of conduct/guiding principles, and depending on the particular

<sup>83</sup> We add "and company auditors (Kansayaku)" to better reflect the situation in Japan.

Element	Yes	No	Source(s) of Rule	Comments
company code of conduct?				corporate governance structure adopted, the board or some other governance organ may oversee enforcement of company rules, etc., to the extent this enforcement falls outside the responsibility of management.
Transparency and Disclosure of Information				
11. Do financial statements comply with International Financial Reporting Standards (IFRS)?	X		FIEA	In the “Opinion on the Application of International Financial Reporting Standards (IFRS) in Japan” (Interim Report), IFRS was optional in financial statements since year ending in March 2010, and compliance is projected to be mandatory around 2012.
12. Are the identities of the five largest shareholders disclosed?	X		CL FIEA	Under the Companies Law and Ministry of Justice regulations, public companies are required to disclose their 10 largest shareholders in their annual report.
13. Is compensation of company executive officers disclosed?	X		CL FIEA	Under the Companies Law and MOJ regulations, public companies are required to disclose (1) the total amount of remuneration for all directors and the number of directors, (2) the total amount of remuneration for all officers and the number of officers, and (3) the policy on compensation decisions if the applicable committee has already decided it. In addition, the company must disclose these items on outside directors independently.
14. Are extraordinary corporate events disclosed?	X		CL FIEA	Under the Companies Law and MOJ regulations, public companies are required to disclose important corporate actions taken in the applicable fiscal year in their annual report, such as with regard to (i) financing, (ii) capital investment, and (iii) M&A.
15. Are risk factors disclosed in securities offering materials?	X		FIEA	Risk factors are disclosed in securities offering materials.
16. Are transactions of a company with its insiders disclosed?	X		CL FIEA	As mentioned above, transactions with insiders are required to be voted on, subject all parties and directors who voted in favor to liability, and are disclosed.

Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory

# Republic of Korea

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in Korea

#### 1.1. Background

In the face of the Asian Financial crisis in the late 1990s, the Korean government carried out partial and full revisions of the Commercial Act and the Securities and Exchange Act to overcome the crisis. The process called on companies to improve their effectiveness and transparency by automating management activities and adapting to global trends. The government sought to adjust the economic environment in sync with the transformation taking hold around the world.

The government is still in the process of revising corporate governance in the Commercial Act aimed at improving corporate governance and management transparency in line with global standards. The revised version of the Commercial Act, pending in the National Assembly, introduced the following articles: Definition of outside directors (Article 382 (3)), Introduction of executive officer (Article 408-2), Extend the scope of director's self-dealing (Article 398 (1), (2)), Director's duty not to usurp corporate opportunity (Article 398 (3)), Release of director's liability (Article 400), Improvement of the auditor (Article 412 (3)).

The Act on capital market and financial investment came into force in February 2009, following its enactment in 2007. It combined six existing laws - Securities and Exchange Law, Futures Trading Act, Indirect Investment Asset Management Business Act, Trust Business Act, Merchant Banks Act, and Korea Securities and Futures Exchange Act. The special provision on corporate governance of listed companies of the repealed Securities and Exchange Law is included in the Commercial Act.

#### 1.2. Trends

	2005	2006	2007	2008	2009
Number of Companies	702	727	745	765	770
Market Capitalization (USD billion equivalent)	580	623	842	510	786

*Source: Korea Listed Companies Association, Merger, April 2010.*

The market capitalization of publicly traded companies dropped by 40% during the global economic crisis in 2008, but recovered by 54% in 2009.

#### 1.3. Key Corporate Governance Rules and Practices

Please refer to Key Corporate Governance Rules and Practices in Korea, p. 128.

## 2. Development, Enforcement and Assessment of Implementation of corporate Governance Rules

### Development of Corporate Governance Rules

In the public sector, the Ministry of Justice spearheaded the arduous process of amending and submitting the amended version of the Commercial Act to the National Assembly. To develop corporate governance that meets global standards, the Ministry took reference of revisions to Commercial Acts from around the world. It took note of the growing importance of corporate governance in the integration of the global market and advancement of financial liberalization, and amended the Act to best reflect global standards and to shore up efficiency. As such, the new version clearly defined the role of the outside director within the board of directors as well as grounds for its disqualification; and introduced an executive officer system. It also stipulates the need to improve audit and audit committee systems to avoid conflict of interest between director and shareholder.

To promote the gradual improvement of corporate governance, the Corporate Governance Service analyzes and compiles data on the level of corporate governance of publicly traded companies. Publicly traded companies are graded annually based upon the results of the evaluation; and the results are made available to the public and used to aid improvement.

### Assessment of Corporate Governance Practices

Grade	Observed	Largely Observed	Partially Observed	Materially Observed	Not Observed	Total
2008 number of companies (%)	10 (1.55)	66 (10.27)	109 (16.95)	371 (57.70)	87 (13.53)	643 (100)
2009 number of companies (%)	7 (1.09)	81 (12.56)	123 (19.07)	353 (54.73)	81 (12.56)	645 (100)

*Source: Corporate Governance Service*

In 2009, 211 of the 654 publicly traded companies (32.72 %) were classified under Partially Observed, a 3.95 % increase from the 185 of the 643 companies (28.77 percent) in 2008. Compared with the previous year, 38 companies saw their grades improved in 2009 (36 companies in 2008) while six companies witnessed a drop in their grades (three companies in 2008).

Following the revised articles on corporate governance of the Commercial Act in 2008, more companies performed well in advancing corporate governance with improvements in the board of directors, the rights of the shareholder and public notice. The improvements in framework and operation of the board of directors were driven in large part by greater involvement of the outside director and the bigger role of special-purpose committees in candidate nomination and compensation. In the revised version of the Commercial Act in 2009, companies with more than two trillion won in market capitalization are obliged to set up an audit committee which is deemed to have bolstered the transparency of management activities.

## **3. Awareness and Advocacy for Good Corporate Governance**

### **3.1. Company Directors**

The Corporate Governance Service evaluates all publicly traded companies on corporate governance and the operation of the board of directors. Its mission is to improve corporate governance to build a healthy capital market culture and to promote greater transparency in management. All publicly traded companies are subject to evaluation regardless of their membership in Corporate Governance Service.

The Korea Listed Companies Association (KLCA) is an organization that manages and supervises all publicly traded companies. The KLCA educates its members on laws related to publicly traded companies in areas such as corporate governance structure, internal accounting control system and securities class action. It also offers classes dealing with current issues surrounding public notice and accounting. These classes are not mandatory.

The Economic Reform Research Institute and the Korea Information Service Inc. jointly provide online services on corporate governance analysis. Users can access the information on the website by clicking on a menu titled “corporate governance”. It provides a thorough analysis on shareholders (ownership structure), board of directors (management), articles of incorporation and related laws.

Publicly traded companies offer education programs based on workers’ performance and work period. Companies offer professional MBA programs or opportunities to study at law school for one to two years.

### **3.2. Media**

There is no educational program focusing on building awareness among print and television journalists to enable them to cover corporate governance responsibly.

The financial press does not regularly report on corporate governance issues and developments.

### **3.3. Educational System**

Corporate governance is taught as part of a course on the Commercial Act.

Corporate governance is a component in courses on corporate audit and company internal control.

Judges and other judicial officers study corporate governance as well as cases related to the Commercial Act and financial group.

### **3.4. Stock Exchange**

KLCA is in charge of managing, supervising and educating publicly traded companies.

The stock exchange does not have outreach programs in support of good corporate governance.

## 4. Corporate Governance of State-Owned and Family-Controlled Enterprises

### 4.1. State-Owned Enterprises

Respecting the independence of state-owned companies, Minister of Strategy and Finance and competent ministers oversee the state's investments in companies within the limit stipulated in the Act on the Management of Public Institutions. Under the law, competent ministers oversee projects entrusted to the state-owned company by the government that are directly related to the work of the ministry and areas set out in relevant laws. Minister of Strategy and Finance, on the other hand, oversee whether state-owned companies are faithfully adhering to management guidelines including guideline on human resource and organization management.

The corporate governance structure of state-owned and private enterprises are similar in juridical sense. As stipulated in Act on the Management of Public Institutions, the number of non-executive directors should account for a half of outside directors including head of board of directors. State-owned enterprises with more than two trillion won in capital are obliged to put in place an audit committee.

Ensuring transparency and efficacy for corporate governance of state-owned companies is an important corporate governance issue. To do so, we believe in the importance of establishing a system that guarantees transparency in nominating prospective candidates to the board of directors. Companies also have to establish a system to properly evaluate and report the performance of state-owned corporations, compensating directors to adequately incentivize and attracting talent.

### 4.2. Family-Controlled Enterprises

One of the major issues is the transfer of management control in some large companies and family-owned enterprises that retain both ownership and management control. The other issue is the practice of "chaebol" owners who expand their control through cross ownership or through shares held by affiliated companies and family ownership.

Since the Asian financial crisis, family-owned enterprises have been striving to create a better business environment by restructuring and putting greater emphasis on the transparency of corporate governance. They have therefore been at the forefront of advancing corporate governance and protecting the rights of small stakeholders by normalizing the function of the board of directors and the shareholders' meeting to effectively oversee chief executive officers and control the dogmatic management of major stakeholder.

## 5. Role of Professional Service Providers in Corporate Governance

*Accounting and auditing firms.* Accounting and auditing firms oversee companies' enforcement of IFRS and reports and companies' performance and fiscal conditions by making their annual report public.

*Rating agencies.* The Corporate Governance Service evaluates publicly traded companies annually on the level of their corporate governance. The evaluation is made public and used to help companies identify areas for improvement.

**Commercial banks.** Investment banks are working to improve the transparency and the effectiveness of corporate governance by establishing an internal control mechanism with the Audit Committee, in line with laws on the capital market and financial investment.

**Securities analysts.** Stock analysts forecast and report the status quo and the future prospects of companies based on their corporate governance analysis and annual report.

**Law firms.** Law firms take part in the development of sound corporate governance by providing information or consultation on corporate governance to the founder or owner of a company when the company goes public.

**Corporate governance consultants.** The Korea Listed Companies Association provides education and consultation on corporate governance free of charge to promote the improvement of corporate governance. The Economic Reform Research Institute and the Korea Information Service work together in analyzing the corporate governance of a company and enable users to browse the information on the web.

## **6. Recent Developments in Corporate Governance**

### **6.1. Corporate Governance Developments**

To better equip Korean companies against fierce global competition, the revised version of the Commercial Act, currently pending in the National Assembly, consists of new developments aimed at shoring up the transparency and the efficacy of corporate governance. It includes the following articles to ease the burdensome regulation on the capital management of companies and to enhance the independence of companies in running a business.

#### ***j) Outside Director System and Executive Officer System***

Starting from 1998, companies are obliged to appoint a minimum of one outside director for the shareholders' meeting. As of 1999, they must also name more than a fourth of their board of directors in the annual shareholders' meeting as outside directors (KOSDAQ-listed corporations or companies with market capitalization of more than two trillion won have to appoint more than three outside directors or fill more than a half of their board of directors with outside directors).

With the revision of the Commercial Act, a company can no longer keep the current audit system if it introduces an audit committee that has more than two-thirds of its board of directors composed of outside directors and an audit committee.

In September 1999, the Ministry of Strategy and Finance announced a standard for corporate governance that calls for the appointment of more than a half of the board of directors from outside directors. Large listed companies, government-funded institutions, and financial institutions have to establish an audit committee; and have more than two-thirds of the board of directors as outside directors. By increasing the number of outside directors, shareholders are able to keep major shareholders in check from pursuing personal gains, and defend the rights of small shareholders.

The executive officer system is also put in place to oversee executive the functions of the board of directors and the chief executives. The board of directors is entitled to appoint or dismiss personnel.

### ***ii) Committee within the Board of Directors***

The revised law adopted the common practice in which the board of directors can establish a sub-committee that exercises the same authority as the board of directors in carrying out tasks passed on from the board. The mission of the sub-committee is to guarantee objectivity and expertise so that the board of directors operate efficiently and make the right decisions. The law stipulates that KOSDAQ-listed corporations and companies with assets of more than 2 trillion won are obliged to establish a sub-committee to recommend candidates for outside directors. It must also fill more than half of the committee with outside directors.

The Ministry of Strategy and Finance advises companies to put in place a compensation committee and obliges listed companies with more than one trillion won in assets (Model Rule of Corporate Governance, 6.2 Principles) to do so. All members of the committee must be outside directors to ensure the committee's independence. (Criterion 6.3)

KOSDAQ-listed corporations or publicly traded companies with more than 1 trillion won in market capitalization can have a full-time auditor or an audit committee. The law was amended to protect the interests of the employees and creditors of corporations with more than two trillion won in market capitalization by establishing a sub-committee that can audit the operation of the board of directors and accounting.

### ***iii) The right of shareholder's proposal***

As the board of directors gained more control, the shareholders meeting slowly lost its influence. To address this concern, the Commercial Act was amended in 1998 to revive the initial purpose of the shareholders meeting by increasing its role in management. Small shareholders were recognized for their right to make proposals that must be addressed in the shareholders meeting. Under the revised Act, shareholders with more than 3% of listed shares, except for shareholders that do not have voting rights (Article 363-2 I of Commercial Act ) can participate in management by making a written proposal to the board of directors six weeks prior to the meeting.

### ***iv) Class Action***

When small shareholders want to take class action against the board of directors, to hold them liable for any damages done to the corporation's interests, the auditor has to file a suit on behalf of the company. Given the difficulty of the circumstance, the law was amended to guarantee *locus standi* for small shareholders. Shareholders with more than 1% of listed shares can file a suit. If they win, they can charge the company for the cost incurred from the lawsuit. If they lose and if both sides agree that there were no bad intentions behind the suit, the shareholders do not have to pay the compensation.

### ***v) Cumulative Vote***

Shareholders are entitled to one vote for each share in the event of selecting and appointing more than two directors. The system was introduced in 1998 when the commercial code was amended to vote for one or more candidates. Based on the articles of association, the cumulative vote can be put aside, thereby leaving room to select or appoint the representative of small shareholders as a director.

### ***vi) Merger and Acquisition***

Article 527-3 of the Commercial Act eased the total number of new shares issued by the surviving company of a merger not to exceed 10/100 of the total issued shares of the company from the initial requirement of 5/100.

Article 523 of the Commercial Act promotes the flexibility of merger consideration, allowing companies to choose between a share of the parent company or cash.

### ***vii) Corporate Social Responsibility***

The role and mission of a company has evolved from satisfying interest groups to take part in addressing social issues in the community that the company belongs to as well as economic, social and environmental issues. More and more companies are called to take greater interest in CSR. As the concept develops, the principle of CSR has been broken down into economic, social, ethical, charity, and environmental responsibilities. To enhance the social confidence and responsibility of companies, there is an ongoing discussion on enacting the “CSR Act” to promote a responsible management and eco-friendly corporate policies.

## **6.3. Current Issues and Challenges for Corporate Governance**

### ***Challenges***

The board of directors was introduced so that corporate decisions can be put to a vote. For the system to be effective, it requires a framework allowing the board of directors to be active in appointing and gathering opinions from executive officers. However, the system is not without fault. It is hard to find the right person for a job as important as the executive director; and directors are selected in the shareholders meeting which means small shareholders have lesser say than major stakeholders.

### ***Financial Crisis***

In August 2006, the Korean government enacted a law on capital market and financial investment to nurture the capital market and to speed up the process of becoming an advanced economy. Upon the outbreak of the global financial crisis, the government came to realize the importance of a fully functioning financial market and sound regulation; and have been working on creating a better system.

Under the revised law, financial investors can rightly demand the appointment of an outside director even in a non-listed company to secure the independence of the board of directors as well as its transparency and authority for supervision.

Major financial institutions must also build an audit committee as should companies that have yet to go public.

With an efficient internal control system up and running, financial investors can better manage potential risks. Chief executive officers can also conduct appropriate supervisory tasks. An internal control system is a standard and procedure that executives must follow at work to prevent conflict of interest and to protect investors.

## Key Corporate Governance Rules and Practices in Korea

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for shareholders' meetings?	X		CL	
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		CL, GP	
3. Must company transactions with its insiders be on a non-preferential basis?	X		CL	
4. Is a super majority vote required for major company acts affecting shareholder rights?	X		CL, CGC	
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors? What percentage?	X		CL, CGC	
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?	X		CL, CGC	
7. Do independent directors decide what information the board receives from management?	X		CL, CGC	
8. Are the chairman of the board and the chief executive officer different persons in the majority of listed companies?	Δ			
9. Are all board members elected annually?		X		
10. Does the board oversee enforcement of a company code of conduct?	X		CL, CGS	
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with International Financial Reporting Standards (IFRS)?	X		SL	
12. Are the identities of the five largest shareholders disclosed?	X		SL	
13. Is compensation of company executive officers disclosed?	X		SL	
14. Are extraordinary corporate events disclosed?	X		SL	
15. Are risk factors disclosed in securities offering materials?	X		SL	
16. Are transactions of a company with its insiders disclosed?	X		SL	

Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory

# Malaysia

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in Malaysia

#### 1.1 Background

The responsibility of ensuring that the level of corporate governance in Malaysia remains high lies with several institutions. The two main laws that contain sections relating to corporate governance (CG) are the Companies Act 1965 (as amended) and the Capital Market & Services Act 2007 (CMSA). The Companies Commission of Malaysia (CCM) plays the chief role in promoting corporate governance by providing the structure, basis and framework of governance that regulate and discipline companies as provided in the Companies Act 1965.

The Companies Act 1965 provides the governance framework for promoting accountability, disclosure and transparency through provisions relating to, amongst others:

- directors' roles and responsibilities;
- investors' protection;
- shareholders' rights (including minority shareholders);
- disclosure of interests by directors;
- integrity of transactions by directors and substantial shareholders;
- protection of whistleblowers;
- keeping of proper accounts and records;
- setting up of internal controls for public companies; and
- lodgment of certain documents and information to the Registrar for public information.

CCM has also introduced two sets of voluntary codes namely the Code of Ethics for Directors and the Code of Ethics for Company Secretaries.

The CMSA, which is the successor law that amalgamated and built upon the Securities Industry Act 1983, the Futures Industry Act 1993 and the fundraising provisions of the Securities Commission Act 1993, regulates the issuance and trading of debt and equity securities and derivatives. The overall objectives of the CMSA are to protect investors and to maintain the integrity of the market for trading of securities and derivatives. The law contains rules for disclosure by securities issuers of material information that investors should know and for fair practices in the trading of securities and derivatives.

The Malaysian Code on Corporate Governance (MCCG) was issued in 2000 pursuant to the recommendations by the High Level Finance Committee on CG reform following the Asian Financial Crisis. The MCCG is a "comply or explain" code that is applicable to all public listed companies (PLCs) on the stock exchange, Bursa Malaysia Securities Berhad (Bursa Malaysia). If a PLC is not in compliance with a provision of the code, it must explain why in its annual report. The MCCG was revised in 2007 (details on the MCCG are provided in 6.1 below).

PLCs are also subject to the Listing Requirements of Bursa Malaysia that include meeting CG standards that are more detailed and stringent than the provisions under the Companies Act. For example, the rules require that a PLC's board of directors have at least one-third independent directors, that independent directors are majority members of an audit committee of the board and that the PLC must have an internal audit function.

The legal framework for corporate governance in financial institutions in Malaysia includes Banking and Financial Institutions Act 1989, Islamic Banking Act 1983, Insurance Act 1996, Takaful Act 1984 and Development Financial Institutions Act 2002. These Acts provide for the observance of prescribed processes and procedures (based on international best practices and standards on corporate governance) by financial institutions. Financial institutions regulated by Bank Negara Malaysia (Central Bank of Malaysia-BNM) are required to observe guidelines issued under the above legislations which set out broad principles and minimum standards on corporate governance in the main areas of board responsibility and oversight, management accountability, risk management and internal controls as well as reporting and disclosures.

## 1.2 Trends

	2005 (Dec)	2006 (Dec)	2007 (Dec)	2008 (Dec)	2009 (Dec)	2010 (Apr)*
No. of PLCs listed	1,021	1,027	987	977	960	959
No. of IPOs	79	40	26	23	14	6
Total Market Capitalisation (RM million)	695	849	1,106	664	999	1,073
Total market Capitalisation (US\$ million)	184	241	334	192	292	339

*\*Note: Figure is as of 21 April 2010*

*Exchange rate US\$1 = RM3.2250 (as at 18 May 2010) Source: BNM*

The number of listed companies has been on a downward trend since 2006 due to a decrease in initial public offerings (IPO) coupled with the increase in privatisation exercises including mergers and acquisitions which resulted in some listed companies being subsumed under other listed companies. Interest in IPOs and equity issuance was also affected by the Global Financial Crisis (GFC). The overall depressed market condition arising from the GFC has resulted in the total market capitalisation of Bursa Malaysia contracting close to 40% in 2008. However, the economy has been recovering strongly since the second half of 2009, resulting in an improvement in market sentiment, pushing up stock prices and market capitalisation.

In line with the improved market sentiment and better outlook for the Malaysian economy, the number of IPOs is expected to increase in 2010. As at 30 April 2010, six new companies had been listed on Bursa Malaysia as compared with zero during the same period in 2009. The improved market sentiment and economy is also expected to attract more sizeable listings onto Bursa Malaysia. In 2009, Maxis Berhad raised RM11.2 billion from the market and added approximately RM39 billion to Bursa Malaysia's total market capitalisation. There is also more interest in secondary fund raising exercises from listed companies via private placements and rights issues in view of the improved market prices and overall better market sentiment.

## 1.3 Key Corporate Governance Rules and Practices

Please see Key Corporate Governance Rules and Practices in Malaysia, p. 146.

## **2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules**

### **2.1 Development of Corporate Governance Rules**

CCM, through the provisions of the Companies Act 1965, is responsible for enforcing the corporate governance framework on all companies irrespective of their economic size or whether or not they are publicly traded. In enhancing the corporate governance framework in Malaysia, CCM has embarked on a holistic review of the Companies Act 1965 to be in tandem with international norms and standards. In addition, CCM is also issuing Practice Notes which are aimed at assisting the general public relating to the implementation of corporate governance rules as follows:

- Practice Note 1/2008 – Requirements relating to the lodgment of annual return of companies;
- Practice Note 2/2008 – Change of financial year;
- Practice Note 7/2010 – Guidelines for auditors to inform the Registrar prior to cessation of office under section 172A of the Companies Act 1965;
- Practice Note 8/2010 – Explanation on the application of thresholds provided for under section 132C(1B) of the Companies Act 1965; and
- Practice Note 9/2010 – Application for extension of time: (i) To convene the annual general meeting of a company; and (ii) to lay out the profit and loss accounts of the company

The Securities Commission (SC) is one of the main proponents of reform to Malaysia's corporate governance framework. The SC plays a key role in the development of the MCCG and works closely with Bursa Malaysia in incorporating the salient provisions of the MCCG into the Listing Requirements of the stock exchange. The SC played a key role in the reform of the securities laws which culminated in the enactment of the CMSA in 2007. Recent amendments to the CMSA widen SC's powers to take action on CG-related offences as elaborated in 6.1 below. Bursa Malaysia has also been instrumental in incorporating rules that promote good corporate governance in its Listing Requirements.

BNM, as the supervisor of banks (including conventional, investment and Islamic banks), insurance and takaful companies and development financial institutions in Malaysia issues standards in the form of guidelines on corporate governance for these financial institutions. These guidelines on corporate governance cover broad areas of board responsibility and oversight, management accountability, risk management and internal controls as well as reporting and disclosures. Board members, senior management and officers primarily responsible for control functions must also comply with fit and proper requirements both at the time of appointment and on an ongoing basis.

### **2.2 Enforcement of Corporate Governance Rules**

The SC is concerned with the enforcement of the securities laws and regulations on matters such as false and misleading statements or material omissions of disclosures, fraud, market manipulations, etc. The SC also has Investors Affairs & Complaints Department which looks into complaints by the public, including in relation to CG-related matters.

In 2009, the SC brought criminal charges against four individuals (including an auditor) who submitted or were involved in submitting false financial information to the SC. The SC also charged two other individuals for their role in defrauding a PLC. Additionally, in using the

wide range of enforcement tools, the SC has taken administrative action in 56 cases and imposed administrative fines. These administrative actions were taken against PLCs, their substantial shareholders, intermediaries and professional advisers. Bursa Malaysia, as the front-line regulator, has also been taking action against directors and PLCs for breaches of the Listing Requirements.

Enforcement of the Listing Requirements (LR) of Bursa Malaysia is taken against PLCs and their directors arising from letters of undertaking by these persons to comply with the LR.

Number of Enforcement Actions (Excluding Reminders and Warnings) Taken against PLCs and Directors in 2008 and 2009

Enforcement Actions Taken	Listed Companies		Directors	
	2008	2009	2008	2009
Private reprimand/private fine	21	11	19	4
Public reprimand	49	65	17	37
Public reprimand & fine	1	-	53	191
Total	71 (44 listed companies)	76 (34 listed companies)	89 (50 directors)	232 (76 directors)

Generally, the enforcement actions taken are for breaches in the following areas:

- Delay in submission and accuracy of financial statements issued;
- In relation to transactions, failure to disclose the transactions, procure shareholders' prior approval and where it involves related-party transactions, failure to appoint an independent adviser to advise the shareholders; and
- Delay in the announcement of material non-financial information.

In the last two years (2008-2009), only one PLC was de-listed due to its non-compliance of disclosure rules (i.e., delay in making financial reporting). In this regard, the LR prescribes that de-listing proceedings would be initiated against a PLC for delay of six months or more from the prescribed time imposed for the issuance of any prescribed financial statements.

Assessments of financial institutions' observance of corporate governance standards are carried out under BNM's risk-based approach to supervision. Assessments of the quality and robustness of a financial institution's oversight and control functions are both the starting point for supervisory evaluations of how an institution is managing the risks inherent within each of its significant areas of activity, and the basis on which BNM forms an overall view of an institution's resilience, particularly under stress conditions. Based on the supervisory assessments, BNM may direct institutions to take specific measures to improve corporate governance within the institution, including measures to strengthen the independence of the board from management and the control functions within the organisation.

CCM filed a civil action against two substantial shareholders in a public listed company for failure to disclose their acquisitions and disposal of the Company shares in a timely manner. In another civil case, CCM commenced winding-up action against a foreign company operating in Malaysia without approval from the Malaysian authorities.

Number of Cases Charged, Convicted and Compounded for Various Serious Corporate Governance Offences under the Companies Act 1965 from 2008 until March 2010

Offense	Year		
	2008	2009	2010 (Jan-March)
Number of cases charged	48	127	26
Number of cases convicted	2	14	7
Number of cases compounded	4	43	17

### 2.3 Assessment of Corporate Governance Practices

Malaysia underwent the ROSC assessment in 2006. Below are the summary results:

Observed	Largely Observed	Partially Observed	Materially Observed	Not Observed
1	26	5	-	-

Principle	Description	Malaysia's Position
<b>I. ENSURING THE BASIS FOR AN EFFECTIVE CORPORATE GOVERNANCE FRAMEWORK</b>		
IA	Overall corporate governance framework	Largely Observed
IB	Legal framework enforceable and transparent	Largely Observed
IC	Clear division of regulatory responsibilities	Largely Observed
ID	Regulatory authorities have sufficient authority, integrity and resources	Largely Observed
<b>II. THE RIGHTS OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS</b>		
IIA	Basic shareholder rights	Largely Observed
IIB	Rights to participate in fundamental decisions	Partially Observed
IIC	Shareholders AGM rights	Largely Observed
IID	Disproportionate control disclosure	Largely Observed
IIE	Control arrangements should be allowed to function	Largely Observed
IIF	The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated	Partially Observed
IIG	Shareholders should be allowed to consult with each other	Largely Observed
<b>III. EQUITABLE TREATMENT OF SHAREHOLDERS</b>		
IIIA	All shareholders should be treated equally	Partially Observed
IIIB	Prohibit insider trading	Largely Observed
IIIC	Board/managers disclose interests	Largely Observed
<b>IV. ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE</b>		
IVA	Legal rights of stakeholders are to be respected	Largely Observed
IVB	Stakeholder redress	Largely Observed
IVC	Performance-enhancing mechanisms	Largely Observed
IVD	Stakeholder disclosure	Largely Observed
IVE	Whistleblower protection	Largely Observed
IVF	Creditor rights law and enforcement	Largely Observed

Principle	Description	Malaysia's Position
<b>IV. DISCLOSURE AND TRANSPARENCY</b>		
VA	Disclosure standards	Largely Observed
VB	Accounting standards	Observed
VC	Independent audit annually	Largely Observed
VD	External auditors should be accountable to the shareholders	Largely Observed
VE	Fair and timely dissemination	Largely Observed
VF	Research conflicts of interests	Largely Observed
<b>V. RESPONSIBILITIES OF THE BOARD</b>		
VIA	Act with due diligence, care	Partially Observed
VIB	Treat all shareholders fairly	Largely Observed
VIC	High ethical standards	Partially Observed
VID	The board should fulfill certain key functions	Largely Observed
VIE	The board should be able to exercise objective judgment	Largely Observed
VIF	Access to information	Largely Observed

### 3. Awareness and Advocacy for Good Corporate Governance

#### 3.1 Corporate Directors

The Malaysian Alliance of Corporate Directors (MACD) is a non-profit entity established in 2009. Its mission is to promote good corporate board governance. MACD is actively engaged in:

- Providing a forum for members to network and exchange ideas, for the advancement of business and public affairs;
- Encouraging education and lifelong learning, for the improvement in members' personal competencies;
- Assisting members in improving their board's efficiency and effectiveness as a whole through its services and interventions; and
- Establishing and maintaining contacts amongst business leaders at the highest level, locally and internationally.

In 2003, BNM launched the International Centre for Leadership in Finance (ICLIF) with the objectives of providing a more focused and coordinated approach towards the development of world-class leaders in the financial services sector in Malaysia and in the region. In its programmes conducted from time to time, ICLIF has always included educational initiatives for Malaysians to value good corporate governance, in its efforts to raise the bar amongst candidates.

Additionally, BNM in collaborative effort with the Malaysia Deposit Insurance Corporation and the International Centre for Leadership in Finance has developed and implemented a Financial Institutions Directors' Education Programme (FIDE) for directors of financial institutions since 2008. FIDE has the objective of strengthening the skill sets and knowledge of directors to effectively discharge their responsibilities and promote excellence in director performance. Through the FIDE Programme, the BNM organises quarterly luncheon talks by

international experts on topics related to corporate governance in the oversight of financial institutions.

Companies Commission of Malaysia Training Academy (COMTRAC) under CCM undertakes efforts to educate stakeholders to enhance public awareness on the need, importance and benefits of complying with the corporate legal provisions. COMTRAC commenced operation in April 2007 to function as the training arm of Companies Commission to elevate and promote ethical business and good governance values to the business and corporate community such as company directors through its Corporate Directors Training Programme (CDTP) which is voluntary in nature. The training programmes being conducted are wide ranging from areas in company law, business law, corporate enforcement and investigations, corporate governance, corporate financial reporting to practice issues and legal procedures, audit and internal control, guidance on how to start a business in Malaysia as well as, labour law and taxation.

On 8 June 2009, Bursa Malaysia issued the “Corporate Governance Guide—Towards Boardroom Excellence” (CG Guide). The CG Guide serves as a reference for PLC directors to better understand their roles and responsibilities as directors of PLCs and the ways in which to enhance CG practices among their boards and committees. The CG Guide contains several recommendations on continuing education for directors and how directors may attain requisite knowledge. These include suggestions on ways in which directors can keep abreast of developments and recommendation as a good practice that the board regularly requests each director to identify appropriate training required to enhance competencies and their contribution to the board.

Since the launch of the CG Guide, Bursa Malaysia has been collaborating with numerous organisations such as the Malaysian Institute of Accountants, the Institute of Internal Auditors Malaysia and the Malaysian Institute of Corporate Governance to hold a series of training programmes on the CG Guide. All directors are recommended to familiarise themselves with the CG Guide and to attend at least one training programme on the Guide.

The SC in collaboration with Bursa Malaysia organised the inaugural “Corporate Governance Week” on 8 June 2009. The SC-Bursa Malaysia CG Week which ended on 11 June 2009 was part of SC and Bursa Malaysia’s initiative in enhancing CG practices amongst PLCs. It is intended to be a platform where all stakeholders involved in the CG process could come together to exchange information, experience and knowledge about best practices in CG. This was achieved through a series of dialogue sessions, seminars, workshops and roundtables involving relevant industry associations. The intention is to make the SC-Bursa Malaysia CG Week an annual event.

The Listing Requirements of Bursa Malaysia incorporate several provisions relating to directors’ continuous training and education. These include the following:

- Paragraph 15.08(1) of the Main Market Listing Requirements mandates that a director of a PLC must ensure that he attends such training programmes as may be prescribed by the Exchange from time to time; and
- Paragraph 15.08(2) of the Main Market Listing Requirements states that the Exchange considers continuous training for directors of PLCs as important to enable the directors to effectively discharge their duties. In this respect, the board of a PLC must, on a continuous basis, evaluate and determine the training needs of its members. The subject matter of training must be one that aids the director in the discharge of his duties as a director. The board must disclose in the PLC’s annual report whether its directors have attended training

for the financial year. Where any of its directors have not attended any training during the financial year, the board must state the reasons thereof in the annual report for each director.

### **3.2 Media**

Bank Negara Malaysia conducts regular and ongoing engagement with the media to educate and provide clarity on issues relating to the governance, management and operations of financial institutions. The SC engages with the media on a regular basis to answer any queries with regard to CG. The media is also often given background briefings which serve as a form of on-the-job training.

The financial press reports periodically on CG issues such as corporate transactions and actions, and contested elections for membership of boards of directors. Reports on CG-related matters are published in the main newspapers quite regularly. There have been instances where corporate governance issues had been exposed as a result of investigative reporting by the financial press. Issues relating to weaknesses in corporate governance are generally heavily scrutinised by the financial press and are widely covered by all media.

An emerging trend in Malaysia is the growing influence and numbers of online news portals and financial blogs which serve as “watchdogs” in monitoring and providing real-time updates on corporate governance issues and developments within public and private sector institutions.

### **3.3 Educational System**

Corporate governance is part of the curriculum in the business and management programmes at the general MBA programmes. Aspects of corporate governance, such as Business Ethics, have been included as components of higher education programmes offered by local and international institutions in Malaysia. For instance, the MBA programme conducted by the Management Centre of the International Islamic University (Malaysia) has offered this programme since 2000 while Universiti Utara Malaysia (UUM) offers Master of Corporate Law.

BNM, in a joint initiative with the Securities Commission of Malaysia, established the Asian Institute of Finance (AIF) in November 2008, to augment human capital development in the financial sector through strengthened institutional arrangements in collaboration with the four training institutions that currently serve the financial services sector, namely Institut Bank-Bank Malaysia (IBBM), Islamic Banking and Finance Institute Malaysia (IBFIM), Malaysian Insurance Institute (MII) and Securities Industry Development Corporation (SIDC). AIF’s mandate includes the provision of training programmes on corporate governance for executives in the financial services industry.

There are training and educational programmes conducted by the SC and ILKAP (i.e., legal and judiciary training institute). Sessions have been conducted for high court judges, sessions court judges as well as deputy public prosecutors on topics such as “Trends in Securities Regulation and Recent Amendments to the Malaysian Securities Law” and “Overview of the Capital Market”.

### **3.4 Stock Exchange**

Bursa Malaysia has mandated training programme for first time directors of PLCs. Under the Listing Requirements, newly appointed directors of PLCs or directors of newly listed companies are required to attend a one-and-half day training programme within four months of being appointed as a director of a PLC or listing of the company. The mandatory accreditation programme is organised by external training providers but the areas covered and the

methodology adopted are subject to Bursa Malaysia's approval to ensure the objectives of the programme are achieved.

As mentioned in 3.1 above, Bursa Malaysia's LR also requires directors to continuously evaluate and determine their own training needs and to disclose the training they have attended for the financial year in the company's annual report. Bursa Malaysia does support credible institute of directors such as the Malaysian Alliance of Corporate Directors.

Bursa Malaysia supports the following programmes in support of good governance:

- Bursa Malaysia collaborates with various industry associations to create awareness and enhance knowledge through the Bursa Malaysia Series of Evening Talks on Corporate Governance. The Evening Talks are aimed at providing a platform for creating awareness, sharing of important CG issues and challenges in the local and international scene with industry professional;
- Bursa Malaysia collaborates with the SC to organise the SC-Bursa Malaysia CG Week which provides an opportunity for stakeholders involved in CG to meet to exchange information, experiences and knowledge about good CG practices. The inaugural SC-Bursa Malaysia CG Week in 2009 attracted a high level of participation from directors and industry professionals and attracted extensive media coverage; and
- To incentivise good CG practices and provide greater transparency on CG practices of PLCs, Bursa Malaysia supports the industry-driven initiative on Corporate Governance Index led by the Minority Shareholders Watchdog Group. This rating index was and will be used to rank PLCs and award those who meet high standards.

## **4. Corporate Governance of State-Owned and Family-Controlled Enterprises**

### **4.1 State-Owned Enterprises**

The federal government of Malaysia holds shares in public listed and unlisted companies through two bodies:

- Minister of Finance (Incorporated) (MOF (Inc.))
- Khazanah Nasional Berhad (Khazanah)

MOF (Inc.) was established as a body corporate under Minister of Finance (Incorporation) Act 1957. This Act empowers MOF (Inc.) to hold, invest, acquire and dispose assets of every description, including shares.

Companies held by MOF (Inc.) that are unlisted are governed by its Memorandum & Articles of Association (M&A) and Companies Act 1965, as well as circulars and directives issued by MOF (Inc.) from time to time. Khazanah, a company formed under the Companies Act 1965, is wholly owned by MOF (Inc.) except one share held by Federal Lands Commissioner. Being the investment arm of the federal government, the companies owned by Khazanah are those which offer growth in share value and dividend payments.

Companies held by Khazanah which are mostly listed companies are governed by its Memorandum & Articles of Association (M&A), Companies Act 1965, Listing Requirements of Bursa Malaysia and Securities Commission Act. Apart from that, the Government-Linked

Company Transformation (GLCT) Programme spearheaded by Putrajaya Committee on GLC High Performance (PCG) that introduces various initiatives, which cover matters relating to governance, shareholder value and stakeholder management that will further enhance performance of GLC companies, also applies to companies held by Khazanah.

The MCCG and Listing Requirements of Bursa Malaysia are applicable to government-linked companies (GLCs) that are listed on Bursa Malaysia. GLCs are expected to be role models on CG, leading the way by displaying exemplary governance.

## **4.2 Family-Controlled Enterprises**

One of the major corporate governance issues for family-controlled companies is adherence to the disclosure requirements under section 132E of the Companies Act 1965. This provision, which has been amended via the Companies Act (Amendments) 2007 and took effect from 15 August 2007, provides stringent disclosure requirements with regard to any transactions or arrangements to be entered into between a company and its directors or shareholders including the requirement for such transactions or arrangements to be first approved by non-interested directors or shareholders at a general meeting.

The provision also requires prior approval from the shareholders before the transactions can be carried out. Mere ratification from the shareholders is not sufficient to regularise the transactions or arrangement entered into by the company with its directors or substantial shareholders. The interested directors or substantial shareholders or persons connected with them are to abstain from voting on the proposed arrangement or transactions. This provision has been regarded as a hindrance by family-owned companies.

CCM views that full adherence to corporate governance requirements should serve as an incentive for a family-owned company to become a listed company as companies which have adopted and implemented good corporate governance principles in their daily operation enjoy greater public confidence. The public will invest in companies that practice good corporate governance as they know that their rights are aptly protected.

# **5. Role of Professional Service Providers in Corporate Governance**

## **Accounting and auditing firms**

Accounting firms play a key role in ensuring that the International Financial Reporting Standards are complied with in companies' financial statements, and auditors are responsible for verifying this. As reporting accountants in relation to securities offerings and corporate transactions such as initial public offerings and mergers & acquisitions, accounting firms are also responsible for the accountant's report on a company's financial performance which is relied upon by investors in making investment decisions.

Since the late 1970s, Malaysia has been adopting accounting standards that are consistent with those issued by the International Accounting Standards Committee (IASC) and now, the International Accounting Standards Board.

The Companies Act 1965 (CA) provides that a company's financial statements must be approved by the annual general meeting of shareholders, and audited by an external auditor prior to its approval. Additionally, the auditors are also required by the CA to state in its audit report whether the financial statements have been prepared in accordance to the Malaysian Accounting Standards Board (MASB)-approved accounting standards. In respect of public

listed companies, the responsibility to comply with the accounting standards rests with the listed corporations, its directors and chief executives. Compliance with the requirements is monitored by the Securities Commission of Malaysia, BNM, the Companies Commissions and Bursa Malaysia for institutions under their respective purview.

To assist better implementation of the Financial Reporting Standards in Malaysia, the Malaysian Institute of Accountants (MIA) establishes the Financial Reporting Standards Implementation Committee (FRSIC). The FRSIC provides guidance on implementation issues. It is expected by the Council of the Malaysian Institute of Accountants that any of its members assuming the responsibilities as independent auditors to observe the Approved Standards on Auditing in the conduct of their audits under all the reporting frameworks as determined by the legislation, regulations, and the promulgations of the MIA. The penalty for non-compliance may result in the revocation of the license by the Ministry of Finance.

### **Rating agencies**

Rating agencies generally do not comment on the quality of CG of companies but they do provide crucial and independent credit opinions that are relied upon by investors in making their investment decisions.

### **Commercial banks**

Commercial and investment banks in their role as corporate advisers to PLCs in relation to corporate transactions (such as securities offerings and mergers & acquisitions) have a duty to undertake due diligence on their corporate clients and the corporate transactions being advised, and ensure that adequate and accurate disclosure are made to investors.

### **Securities analysts**

In their analyses of companies' performance and prospects, securities analysts have increasingly commented on the corporate governance of the companies and their directors.

### **Law firms**

As legal advisers and solicitors to PLCs, law firms play an important role in advising, preparing and reviewing submissions and filings to the authorities such as the SC, including prospectuses and offering documents that are issued in relation to securities offering and takeovers and mergers. They provide advice to PLCs in ensuring that the submissions and filings are in accordance with laws and regulations.

### **Corporate governance consultants**

CG consultants assist companies in understanding and complying with new corporate governance requirements. They also provide advice on areas such as investor relations.

## **6. Recent Developments in Corporate Governance**

### **6.1 Corporate Governance Developments**

The MCCG introduced in 2000 essentially aims at setting out best practices on structures and processes that companies may use in their operations towards achieving the optimal governance framework. The revision to the MCCG which came into effect on 1 October 2007, strives to strengthen the roles and responsibilities of the board of directors and audit committee, ensuring that they discharge their duties effectively.

To ensure that the board is represented by the right candidates to serve the board, the Nominating Committee which is tasked to nominate the right candidate to the board is required to evaluate the candidates’:

- skills, knowledge, expertise and experience;
- professionalism; and
- integrity.

In case of independent non-executive directors, the Nominating Committee should also evaluate the candidates’ ability to discharge such responsibilities or functions as expected from independent non-executive directors.

Apart from the above, the Nominating Committee is also tasked to evaluate the effectiveness of the board as a whole, the committees of the board and the contribution of each individual director on a continuous basis.

While the provision on composition of the board remains the same as before whereby one-third of the board shall be represented by independent non-executive directors, the revised MCCG strives to strengthen the role of Audit Committee by requiring the Audit Committee to be fully comprised of non-executive directors only. In addition, the financial literacy of the Audit Committee is emphasised whereby all members of the Audit Committee should be able to read, analyse and interpret financial statements so that they will be able to effectively discharge their functions.

The Listing Requirements of Bursa Malaysia were amended to raise the CG standards amongst PLCs and enhance investor confidence. The key amendments are in the following aspects:

- Requiring all Audit Committee members to be non-executive directors;
- Mandating the internal audit function in PLCs and requiring the internal audit function of PLCs to report directly to the Audit Committee;
- Enhancing disclosure in the annual reports of PLCs to include information pertaining to the internal audit function;
- Expanding the functions of the Audit Committee to include the review of the adequacy of the competency of the internal audit function;
- Setting out the rights of Audit Committee to convene meetings with external auditors, internal auditors or both, excluding the attendance of other directors and employees of the PLC;
- Clarifying that Bursa Malaysia may impose such other requirements relating to the financial-related qualifications or experience that must be fulfilled by at least one Audit Committee member and the signatory to the statutory declaration in relation to the accounts; and
- Requiring PLCs to submit a copy of written representation or submission of external auditors’ resignation to Bursa Malaysia as provided under section 172A of the Companies Act 1965.

Amendments to the securities laws that were passed by Parliament late last year are expected to bring about critical enablers in the SC’s continuing efforts to improve the quality and governance standards of PLCs. The establishment of the Audit Oversight Board (AOB) under the auspices of the SC in April 2010 will provide independent oversight of auditors who audit public-interest entities (PLCs, banks, insurance companies and capital market intermediaries).

Now more than ever the accounting industry's role as gatekeeper in terms of auditing public companies is critical to promoting transparency of financial reporting.

The CMSA introduced new provisions which widened the enforcement powers of the SC. Under the CMSA, the SC, through civil actions, can obtain compensation of up to three times the pecuniary gain made or loss avoided for a range of offences including false trading, stock market manipulations and the use of manipulative and deceptive devices. Section 318 empowers the SC to remove from office any chief executive or director or bar such person from being a director if he is unfit to take part in the management of the listed company.

Furthermore, Section 320 of the CMSA imposes a mandatory duty upon auditors and specific employees of listed corporations to report breaches of securities law and the rules of the stock exchange to the authority. Some of these reports have led to enforcement action being taken against the perpetrators who are often the directors and senior management of the company.

Further amendments were made to the CMSA that came into force from April 2010. Under the two new sections of the CMSA, i.e. sections 317A and 320A, the SC is given the power to act against directors and officers of PLCs who cause wrongful loss to their company. The SC also can act against any person who misleads the public through falsification of the financial statements of PLCs. The new provisions provide even more scope and better enforcement tools for the SC to quickly step in and take action where action is needed.

The Companies Act (Amendments) 2007 (The Amendments) has accorded a statutory recognition on the function on the board of directors to manage the business and affairs of the company. Such statutory empowerment is in line with the recommendation of the High Level Finance Committee on Corporate Governance to clarify the functions and powers of the board of directors.

The Amendments also extend the definition of "director" to include the chief executive officer, the chief operating officer, the chief financial controller and any person who is primarily responsible for the operations or financial management of a company. As such, officers holding key management positions especially those who head the operations or financial management of a company are now subject to similar duties and responsibilities imposed on directors.

The Amendments accord better protection to shareholders especially minority shareholder whereby they are allowed to initiate derivative action against the company subject to the new provision under section 181A of the Companies Act 1965. The new provision provides for proceedings to be brought or intervened in on behalf of a company and the persons who are given locus standi to apply to Court to bring an action or intervene in any action on behalf of a company. The Amendments not only give recognition to the principles of common law on derivative actions, it enhances the remedies available to minority shareholders.

The Amendments also widen the requirement for disclosure of interests in contracts/property undertaken by the management of a company to ensure the level of transparency is not compromised. This is to avoid a situation of conflict of interest which may arise, for instance, when a company transacts with directors, major shareholders or connected persons. In this respect, the Amendments have clarified the provision relating to transactions by a director or a substantial shareholder. The new provision retains the prohibition of any arrangements or transactions involving a director or a substantial shareholder or persons connected with the director the substantial shareholder from acquiring or disposing shares or non-cash assets of the requisite value with the company. Such transaction or arrangement is void unless a prior approval has been obtained at a general meeting or by a resolution of the holding company at a

general meeting. This requirement is a departure from the previous practice where ratification at a general meeting was sufficient to regularise the transaction or arrangement.

In relation to corporate social responsibility (CSR), the Prime Minister of Malaysia had announced in his 2007 budget speech that PLCs are required to disclose their CSR activities. Such activities, which are in line with the economy's socio-economic objectives, include providing business opportunities to domestic entrepreneurs, ensuring ethnic diversity in employment; as well as developing human capital.

The Bursa Malaysia CSR Framework for PLCs was launched on 5 September 2006. The CSR Framework provides a guide to Malaysian companies to develop CSR strategies as well as communicate them effectively to stakeholders. The CSR Framework looks at four main focal areas for CSR practice, namely environment, workplace, community and the marketplace. The framework supports the new rules incorporated in Bursa Malaysia Listing Requirements that require reporting of CSR activities by PLCs in their annual reports.

As the regulator for the business and corporate community, CCM has:

- launched the Corporate Responsibility Agenda on 30 June 2009 which outlines the strategic framework of CCM's approach towards corporate responsibility (CR); and
- established collaboration with external parties such as university, United Nations Children's Fund, Malaysian National University and Malaysian Institute of Integrity (IIM) in relation to CR.

A recent development which may contribute to the strengthening of corporate governance in Malaysia is the Whistleblower Protection Bill 2010, which was passed by House of Representative on 20 April 2010 and The Senate on 6 May 2010. The Bill grants protection to a person who makes disclosure of a criminal offense or a disciplinary offense (whistleblower) in the following ways:

- protection of confidential information;
- immunity from being subject to any civil or criminal liability or any liability arising by way of administrative process, including disciplinary action; and
- protection against detrimental action, i.e., no person may take detrimental action against a whistleblower or any person related to or associated with the whistleblower, including actions affecting the whistleblower's employment or livelihood, in reprisal of a disclosure of improper conduct.

## **6.2 Enforcement of Corporate Governance Rules**

The SC uses an array of tools to enforce the securities laws. Criminal charges for example, are preferred in cases involving serious breaches of the law, such as corporate fraud and financial misstatements. In 2009 alone, the SC brought criminal charges against four individuals (including an auditor) who submitted or were involved in submitting false financial information to the SC, and charged two other individuals for their role in defrauding a PLC. The SC also pursues actions using its civil powers particularly where there is a clear need to reconstitute investors who have suffered loss.

In 2009, for example, a landmark settlement in the amount of RM31 million was reached in the Swisscash investment scam and eligible investors are in the process of being restituted following the court's approval of the eligibility criteria. In addition, the SC has used its civil powers under the securities laws to appoint a receiver over the assets held by a fund manager. Apart from court based enforcement actions, the SC also pursues administrative actions to

achieve swift and effective resolutions. In 2009, for example, the SC meted out 56 administrative sanctions which included the imposition of administrative fines amounting to RM770,000. Administrative actions taken involved PLCs, their substantial shareholders, market intermediaries and professionals.

Bursa Malaysia has also been actively enforcing its Listing Requirements. In the last six months, for example, Bursa Malaysia has publicly reprimanded three PLCs as well as imposed public reprimand and fines on their directors for failure to comply with the listing rules in relation to financial reporting, disclosure and corporate transactions. CCM has prosecuted a significant number of criminal cases under Companies Act 1965 ranging from non-compliances to serious corporate governance offences. Meanwhile, in averting/reducing the risks to financial stability, BNM also has the power to direct financial institutions to take specific measures to improve corporate governance within the institution, including measures to strengthen the independence of the board from management and the control functions within the organisation (also see 2.2).

### **6.3 Current issues and Challenges for Corporate Governance**

#### **6.3.1 Challenges**

Minority shareholders are cautious of taking action against the board of directors due to potential implications of legal costs and time required to initiate the legal action. Despite statutory amendments to section 181A-E in the Companies Act 1965, minority shareholders are still wary of invoking their rights, unless they have sufficient resources.

The role and impartiality of independent directors who are supposed to maintain good governance are being questioned. Independent directors seem to remain in office for too long and may be more inclined to support the decisions made by the board of directors without fully discharging their “oversight” responsibilities.

Regulators need to keep abreast of recent changes in corporate practice in order to be “market-friendly”. It is important for regulators to encourage risk taking within the boundaries of the law. Simply, put, the regulators need to be more “street smart”.

The issue of form over substance hinders effective board functions. Mere compliance with rules and regulations is a first step but PLCs need to go deeper into embracing the spirit of such rules and regulations, enabling smooth and valuable implementation of processes and functions.

Creating and developing a talent pool of professional directors is another area that needs attention. Diversity of skills among directors provides companies with a varied mix of skill sets to deal effectively with increasingly complex business situations. But many companies in Malaysia rely on directors from a small if not limited talent pool. As more local companies globalise, they will meet different and challenging business environments and standards of conduct. Candidates for board appointment must therefore be suitably skilled, competent, and have the ability to offer fresh perspectives to the board, while ensuring appropriate challenge and enquiry.

A director’s mindset can also sometimes be an impediment. Some directors fail to see the importance of continuous training and to sacrifice a substantial amount of time going through the training. The lackadaisical attitude towards continuous training stems from their ranking experience higher than further education.

Notwithstanding the proactive role played by the Minority Shareholders' Watchdog Group, there is ongoing discussion and debate as to how shareholders activism can be further enhanced. Discussions on this topic include the desire to promote greater institutional shareholder activism as such shareholders have the means to be responsible company owners.

Challenges faced by Bursa Malaysia in its efforts to promote understanding of and compliance with better standards and practices of CG include the following:

- In some of its engagements with institutional investors to promote awareness of how the exercise of shareholders' rights can influence company behavior, some were not too receptive to its proposals. This was due to the following reasons:
  - The organisations are restricted by their current policies in engaging with their investee companies; and
  - Top management are not very receptive.
- In its efforts to place greater emphasis on directors' education to improve professionalism and quality of boardroom, Bursa Malaysia has embarked on various educational and awareness activities such as trainings, dialogues, conferences and direct engagements. The educational efforts are voluntary in nature and as such, Bursa Malaysia faces challenges in getting directors to attend.

### **6.3.2 Priorities for Reform**

The legal and regulatory framework for CG is already in place in Malaysia and it is in line with most international best practices. Notwithstanding this solid foundation, it is a priority for the SC to continuously enhance the CG framework. In addition to strengthening the legal and regulatory framework to ensure enforcement of regulatory discipline, other pillars of CG are also import. The pursuit of high growth must be accompanied by robust governance arrangements, greater shareholder activism, collective market discipline and most importantly greater self-discipline on the part of the PLCs and market intermediaries.

In its efforts to enhance the CG standards/practices in Malaysia, Bursa Malaysia focuses on:

- Strengthening the provisions CG in the Listing Requirements (LR);
- Engaging with companies to adhere to good CG practices;
- Enforcing the LR for any breach of CG requirements; and
- Creating and enhancing awareness by shareholders of their rights and assertion of those rights.

Through a "balanced enforcement approach", CCM is actively encouraging continuous learning opportunities for directors and other officers of the company. CCM offers courses and seminars through the Training Academy (COMTRAC), which include courses on corporate governance, anti-money laundering, company secretarial practice and insolvency. Action is also taken to reform the law and presently, CCM is drafting a new Companies Act.

### **6.3.3. Financial Crisis**

Following the Asian financial crisis in 1997, strengthening corporate governance has already been a central focus of capacity building measures aimed at providing a strong foundation for a stable and more resilient financial system. A strong corporate governance framework, supported by sound governance practices, was also identified as an imperative for the transition from a prescriptive, rule-based regulatory regime to a more principle-based regime with greater reliance placed on the internal oversight functions within financial institutions to manage and

control risks. The resulting standards on corporate governance adopted by financial institutions in Malaysia are built on the following key tenets:

- Clear separation of management and oversight functions;
- Adequately competent and committed boards;
- Presence of a strong independent element on the board;
- A clear, explicit and dedicated focus on the oversight responsibilities of the board for risk, internal controls, remuneration, and directors and management performance and succession;
- Rigorous fit and proper assessments for key functionaries;
- Incentive structures that are aligned with long-term performance and the interests of Depositors and policyholders, in addition to shareholders;
- Explicit responsibilities of the board for related party transactions; and
- Sufficient reporting and disclosures on corporate governance practices.

While financial institutions in Malaysia have made significant advances in the area of corporate governance, governance practices will need to continue to evolve to take into account the changing environment. In the immediate to medium-term, pertinent developments include the greater use of and reliance on sophisticated risk management tools to identify, measure and manage risks with the implementation of the Internal Ratings-Based Approach under Basel II and the Risk-Based Capital Framework for Insurers. In addition, higher volatility and potential contagion exists as more financial institutions expand across borders and financial markets become more integrated while uncertainties remain in the pace and strength of global recovery.

Other developments include the changing regulatory landscape which envisages more stringent capital requirements, more discretionary accounting practices and more explicit expectations of financial institutions to manage capital resources using through-the-cycle approaches. The development of Islamic finance will gain further momentum leading to an increasing array of new Islamic products and instruments, thus posing unique Shariah challenges. Intense competition in certain market segments has also restored the appetite for financial innovation, while competition for talent will similarly intensify.

Challenges faced in the financial sector as a result of these developments include the following:

- Designing processes and structures for effective oversight at the group level and on a cross-border basis;
- Applying appropriate controls over the use of models and the exercise of management discretion and judgment;
- The effective integration of risk management and internal control functions how these should interact to support the ongoing oversight of risk;
- Continuing and sustained oversight of how incentive structures within the institution are responding to risk, competition and innovation;
- Approaches for more effective engagements with stakeholders as part of efforts to manage expectations and preserve confidence particularly in times of stress;
- Effective design of programmes for board members to be continuously kept abreast of the latest developments in the financial industry; and

- In Islamic finance, the need to account for the unique features of Shariah principles in risk management and governance.

In preparing for the challenges faced in dealing with crisis in the financial sector, particularly governance issues in the supervisory framework, the new Central Bank of Malaysia Act 2009 has put in place a mechanism for facilitating inter-agency collaboration where financial stability powers need to be invoked that are beyond the regulatory reach of the Bank. The decision to exercise such powers is taken by the Financial Stability Executive Committee (FSEC) which is made up of Bank Negara Malaysia, Ministry of Finance and other relevant supervisory authorities to enhance the efficacy of decision making.

## Key Corporate Governance Rules and Practices in Malaysia

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
Do shareholders add items to the agenda for shareholders' meetings?	X		CL	<p>Section 151 of the CA allows a certain proportion of shareholders to require the company to circulate their proposed resolutions or statements to be considered at the company's AGM. It states that it is the duty of company, on the requisition in writing of a member or members representing not less than 5% of the total voting rights or 100 shareholders holding shares on which there is an average paid-up capital per member of not less than RM500 at the expense of the requisitionists:</p> <p>(i) to give to members of the company entitled to receive notice of the next annual general meeting, notice of any proposed resolution which may properly be moved and is intended to be moved at the meeting; and</p> <p>(ii) to circulate to members entitled to have notice of any general meeting sent to them any statement of not more than 1000 words with respect to the matter referred to in any proposed resolution or the business to be dealt with at the meeting.</p> <p>Section 151(4)(a) of the CA stipulates that a company is not required to give notice of any resolution or to circulate any statements unless a copy of the requisition signed by the requisitionist is deposited not less than six weeks prior to the meeting in the case of a requisition and in the case of any the requisition, it should be deposited not less than one week before the meeting.</p>
Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		GP	Shareholders are becoming more proactive in asking questions of directors at shareholders' meetings and they do receive some answers. The Minority Shareholders Watchdog Group plays a proactive role during company AGMs/EGMs.
Must company transactions with its insiders be on a Non-preferential basis	X		CL, SLR	<p>Section 132E of the Companies Act 1965 prohibits a company from entering into a transaction with a related party unless prior approval is obtained from the shareholders at a general meeting. Section 132E(93) states that only disinterested shareholders can participate in the discussion and vote on the resolution.</p> <p>Where any one of the percentage ratios of a related party transaction is 5% or more, the listed issuer must appoint an independent adviser who must comment as to:</p> <ul style="list-style-type: none"> <li>• whether the transaction is fair and reasonable so far as the shareholders are concerned; and</li> <li>• whether the transaction is to the detriment of minority shareholders;</li> <li>• and such opinion must set out the reasons for, the key assumptions made and the factors taken into consideration in</li> </ul>

Element	Yes	No	Source(s) of Rule	Comments
				<p>forming that opinion;</p> <ul style="list-style-type: none"> <li>• advise minority shareholders on whether they should vote in favour of the transaction; and</li> <li>• take all reasonable steps to satisfy itself that it has a reasonable basis to make such comments and advice.</li> </ul>
Is a super majority vote required for major company acts affecting shareholder rights?	X		CL	Section 65 of the Companies Act 1965 states that the rights of different classes of shares may be varied in accordance to the provisions of the articles or memorandum authorizing such variation. In addition, holders of 10% of the issued shares of a particular class may apply to Court to cancel any variation of rights and the variation shall not have effect until confirmed by the Court
<b>COMPOSITION AND ROLE OF BOARD OF DIRECTORS</b>				
Must boards have independent directors?	X		SLR	<p>A listed issuer must ensure that at least two directors or one-third of the board of directors of a listed issuer, whichever is the higher, are independent directors.</p> <p>If the number of directors of the listed issuer is not three or a multiple of three, then the number nearest one-third must be used.</p>
Do independent directors oversee (i) internal and external audit and (ii) executive compensation?	X		SLR MCG	<p>The audit committee oversees the internal and external audit and both the listing requirements and Code requires the audit committee to consist of non-executive directors, a majority independent.</p> <p>The remuneration committee consisting wholly or mainly of non-executive directors oversees the executive compensation.</p>
Does an independent director decide what information the board receives from management?	X		MCG	<p>The chairman of the board should undertake primary responsibility for organising information necessary for the board to deal with the agenda and for providing this information to directors on a timely basis.</p> <p>The chairman is in most cases independent.</p>
Are the chairman of the board and chief executive officer different persons in the majority of listed companies?	X		MCG	There should be a clearly accepted division of responsibilities at the head of the company which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision.
Are all board members elected annually?		X	CL	Article 63 of Table A of the Companies Act 1965 states that at the first general meeting, all directors shall retire from office and at the AGM in every subsequent year, 1/3 <sup>rd</sup> of the directors shall retire from office. A retiring director shall be eligible for re-election.
Does the board oversee enforcement of a company code of conduct?	X		SLR	In Malaysia, most public listed companies will comply with the Code on Corporate Governance as the Code is also supported by a mandatory reporting of compliance requirement. Hence, companies in Malaysia do not normally develop their own internal code of conduct for directors.
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
Do financial statements comply with IFRS?	X		CL	Section 166A of the Companies Act 1965 requires financial statements to be prepared in accordance with the approved accounting standards. The setting of accounting standards is under the purview of the Malaysian Accounting Standards Board.
Are the identities of the five largest shareholders disclosed?	X		CL/SR	The Companies Act 1965 requires information pertaining to shareholders be lodged with the Registrar through the company's annual return. For listed companies, the annual report will disclose the list of substantial shareholders as well as the names of the 30 securities account holders having the largest number of securities from each class of equity securities and convertible securities according to the Record

Element	Yes	No	Source(s) of Rule	Comments
				<p>of Depositors.</p> <p>To disclose in the annual report:</p> <p>The names of the <b>30</b> securities account holders having the largest number of securities from each class of equity securities and convertible securities according to the Record of Depositors (without aggregating the securities from different securities accounts belonging to the same person) and the number and percentage of equity securities and convertible securities of each class held. In the case of securities account holders which are authorised nominees as defined under the Securities Industry (Central Depositories) Act 1991, information in the account qualifier field of the securities account must also be stated.</p>
Is the compensation of company executive officers disclosed?	X		SLR	<p>To disclose in the annual report:</p> <p>The remuneration of directors of the listed issuer for the financial year and in the following manner:</p> <p>(a) the aggregate remuneration of directors with categorisation into appropriate components (e.g. directors' fees, salaries, percentages, bonuses, commission, compensation for loss of office, benefits in kind based on an estimated money value) distinguishing between executive and non-executive directors; and</p> <p>(b) the number of directors whose remuneration falls in each successive band of RM50,000 distinguishing between executive and non-executive directors.</p>
Are extraordinary corporate events disclosed?			LR	<p>The following are some examples of events which may require immediate disclosure by the listed issuer under paragraph 9.04 of the Listing Requirements:</p> <ul style="list-style-type: none"> <li>a) the entry into a joint venture agreement or merger;</li> <li>b) the acquisition or loss of a contract, franchise or distributorship rights;</li> <li>c) the introduction of a new product or discovery;</li> <li>d) a change in management;</li> <li>e) the borrowing of funds;</li> <li>f) the commencement of or the involvement in litigation and any material development arising from such litigation;</li> <li>g) the commencement of arbitration proceedings or proceedings involving alternative dispute resolution methods and any material development arising from such proceedings;</li> <li>h) the purchase or sale of an asset;</li> <li>i) a change in capital investment plans;</li> <li>j) the occurrence of a labor dispute or disputes with sub-contractors or suppliers;</li> <li>k) the making of a tender offer for another corporation's securities;</li> <li>l) the occurrence of an event of default on interest, principal payments or both in respect of loans; [Cross reference: Practice Note 1]</li> <li>m) a change in general business direction;</li> <li>n) a change of intellectual property rights;</li> <li>o) the entry into a memorandum of understanding; or</li> <li>p) the entry into any call or put option or financial futures contract.</li> </ul>
Are risk factors disclosed in securities offering materials?	X		SL	Under SC's Prospectus Guidelines, risk factors which prospective investors should consider need to be disclosed.
Are transactions of a company with its insiders disclosed?	X		SLR/ CL	<p>Related party transactions</p> <p>(1) Where any one of the percentage ratios of a related party transaction is 0.25% or more, a listed issuer must announce the related party transaction to the Exchange</p>

Element	Yes	No	Source(s) of Rule	Comments
				<p>as soon as possible after terms of the transaction have been agreed, unless:</p> <ul style="list-style-type: none"> <li>(a) the value of the consideration of the transaction is less than RM250,000; or</li> <li>(b) it is a Recurrent Related Party Transaction.</li> </ul> <p>The listed issuer must include the information set out in Appendices 10A and 10C in the announcement.</p> <p>(2) Subject to subparagraphs (9) and (10) below, where any one of the percentage ratios of a related party transaction is 5% or more, in addition to subparagraph (1), a listed issuer must:</p> <ul style="list-style-type: none"> <li>(a) send a circular which includes the information set out in Appendix 10B and Appendix 10D to the shareholders. The draft circular must be submitted to the Exchange together with a checklist showing compliance with Appendices 10B and 10D;</li> <li>(b) obtain its shareholder approval of the transaction in general meeting; and</li> <li>(c) appoint an independent adviser who is a corporate finance adviser within the meaning of the SC's Principal Adviser Guidelines, before the terms of the transaction are agreed upon.</li> </ul> <p>(3) The independent adviser must, in relation to the transaction:</p> <ul style="list-style-type: none"> <li>(a) comment as to: <ul style="list-style-type: none"> <li>(i) whether the transaction is fair and reasonable so far as the shareholders are concerned; and</li> <li>(ii) whether the transaction is to the detriment of minority shareholders, and such opinion must set out the reasons for, the key assumptions made and the factors taken into consideration in forming that opinion;</li> </ul> </li> <li>(b) advise minority shareholders on whether they should vote in favour of the transaction; and</li> <li>(c) take all reasonable steps to satisfy itself that it has a reasonable basis to make the comments and advice in subparagraphs (a) and (b) above.</li> </ul> <p>(a) Subject to subparagraph (9) below, for a related party transaction where any one of the percentage ratios is 25% or more, in addition to subparagraph (2) above, the listed issuer must, before the terms of the transaction are agreed upon, appoint a main adviser, who is a Principal Adviser. The Principal Adviser must ensure that such transaction:</p> <ul style="list-style-type: none"> <li>(i) is carried out on fair and reasonable terms and conditions, and not to the detriment of minority shareholders of the listed issuer; and</li> <li>(ii) complies with the relevant laws, regulations or guidelines where applicable, ensure full disclosure of all information required to be disclosed in the announcement and circular; and</li> <li>(iii) confirm to the Exchange after the transaction has been completed and all the necessary approvals have been obtained, that it has discharged its responsibility with due care in regard to the transaction.</li> </ul>

Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory



# Mexico

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in Mexico

#### 1.1 Background

There are two key laws affecting corporate governance: the Company Law (LGSM), and the Securities Market Law (LMV). The LGSM, enacted in 1934 and most recently amended in 2009, establishes basic company forms and shareholder rights. The LMV, which regulates public companies, was introduced in 1975, but major amendments went into effect in 2001.

Also in recent years, there have been a number of major reforms related to corporate governance in Mexico, including the drafting of an early voluntary code of best practice (1999) and the redrafting of key provisions of the Securities Market Law. In efforts to address the problems of poor corporate governance and a weak financial market, a new Securities Market Law (LMV) was enacted in Mexico in 2006.

The progress that has been made in promoting good corporate governance has been set against the concentrated ownership and control structure of many Mexican firms, weak enforcement of shareholder rights and concerns about reform fatigue.

In addition to encouraging corporate governance, the LMV promotes venture and private capital flows into small and medium-sized companies, through increased transparency, disclosure and better board structures, procedures and clearly defined responsibilities of boards and individual directors. More specifically, the new LMV intends to improve the regulation of information disclosure and minority shareholder rights. It reorganizes and clarifies the duties and liabilities of the board of directors and the relevant officers

Also, Mexican committees now need to create at least one committee which acts as an audit and corporate practices committee. These committees must consist of only independent directors (with the exception of controlled companies, which may have a corporate practices committee comprised of a majority of independent directors). The board has to be comprised of, at least, 25% independent directors.

According to the 2007 Financial Sector Assessment Program (FSAP) Update by the International Monetary Fund (IMF), the law changed the securities market framework in three broad areas. It expanded the CNBV's authority, it introduced significant changes in the corporate governance of publicly listed companies; and it created "two new corporate vehicles, designed to facilitate the ability of small and medium-sized companies to raise capital and transition to public listed company status".

Another area where progress has been made concerns the foundation of a director training organization. The 2003 World Bank's ROSC had noted the absence of such an institution as a

key missing ingredient in Mexico's corporate governance reforms. The Center for Excellence in Corporate Governance (Centro de Excelencia en Gobierno Corporativo, or CEGC) was founded in March 2004. Its objectives are to provide board members and executives with information, methodologies and best corporate governance practices that will increase efficiency and transparency levels, facilitate compliance with existing regulations, and generate greater investor confidence to enhance their economic and social value.

## **1.2 Trends**

The stock Exchange (Bolsa Mexicana de Valores –BMV) is a member-owned, for-profit institution. The 2007 IMF update on its original FSAP notes that between 1995 and 2001, trading activity as well as the number of listed companies on the BMV declined. As the IMF notes, Mexico's equity market remains relatively small and illiquid, and is not a major source of financing for most companies. Among the eight largest economies in the Americas, relative to GDP, Mexico nonetheless has the second smallest stock market. After a number of compulsory delistings by the CNBV, the number of listings declined to 132 (155 listed stocks).

The daily trading volume on the BMV is highly concentrated in a very small number of issuers. Four stocks (Telmex, AMX, Walmex, and Cemex) comprise approximately 50% of the primary equity market index (Indice de Precios y Cotizaciones, or IPC). Overall, the IMF notes, market capitalization of the BMV has grown from US\$104 billion in December 2002 to US\$236 billion at the end of 2005. According to the World Federation of Exchanges (WFE) website, market capitalization reached US\$336.7 billion in January 2010. There are 406 listed companies, of which 125 are domestic and 281 are foreign. The value of shares trading on the BMV was US\$10.1 billion, whereas the value of the 244 bonds trading on the market in January 2010 reached US\$13.1 million.

## **1.3 Key Corporate Governance Rules and Practices**

See Key Corporate Governance Rules and Practices in Mexico, p. 159.

# **2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules**

## **2.1 Development of Corporate Governance Rules<sup>84</sup>**

The capital market regulator is the CNBV. It is a supervisory arm of the Secretariat of Finance and Public Credit (Secretaría de Hacienda y Crédito Público, or SHCP) and supervises banks and the securities market and enforces shareholders rights. The CNBV is headed by a 10-member Board of Governors. Five members, including the President of the Commission, are appointed by the SHCP, three members are appointed by the Central Bank, and the pension regulator and the insurance regulator each appoint one member.

## **2.2 Enforcement of Corporate Governance Rules**

The World Bank assessments note that progress in establishing a successful structure and culture for good corporate governance has to account for the concentrated ownership and control structure of many Mexican firms, and, at least at the time of the assessments, weak enforcement of shareholder rights.

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<sup>84</sup> "Rules" refers to requirements for corporate governance however they are designated; e.g., laws, regulations, stock exchange listing requirements, or principles in obligatory codes.

As the Institute of International Finance (IIF) notes, traditionally, most large companies have been organized as business groups, which are conglomerates owned and controlled by families and/or consist of holding companies that invest in other companies characterized by vertical or horizontal integration. The resulting cross-shareholding between firms and the exchange of positions in boards of directors result in various interlocking directorates. Consequently, while members of the board may come from outside the corporate structure of the firm, they are not necessarily independent.

The IIF cited several studies that indicated that adherence to the principles of the Corporate Governance Code was not commonly observed in the areas of board composition, independence of the audit committee, existence of a committee of compensation and evaluation, and disclosure of compensation schemes for executives. However, especially in the area of director independence, progress in promoting the inclusion of independent board members and establishing audit committees as part of firms' control functions was already under way at the time of the 2003 assessments, and has been further advanced since.

This is especially due to the passage of the new 2006 Securities Market Law, which gives many corporate governance provisions the statute of law. However, structural change is slow, as noted in a 2009, the Mexican business environment is still characterized by concentrated ownership, interlocked boards of directors, inadequate insider trading enforcement, and an overall poor protection of minority investors.

Since 2008, the CNBV has imposed at least 32 sanctions on different entities under its supervisory and regulatory scope. These entities comprise, but are not limited to: financial entities; officers of financial entities; natural persons acting as investors; issuers; natural persons acting on behalf of issuers; companies providing services to investment societies; investment societies; officers of companies providing services to investment societies; members of the board of investment societies; and officers of investment societies. Sanctions are made public. For better references please visit the following website: [http://www.cnbv.gob.mx/seccion.asp?sec\\_id=543&com\\_id=0](http://www.cnbv.gob.mx/seccion.asp?sec_id=543&com_id=0)

As for failure to comply with corporate governance rules and ulterior delistings, up to now, although some companies have been delisted at least since 2007, there has been no delisting due to factors directly linked to the non-compliance of any corporate governance issue.

### **2.3 Assessment of Corporate Governance Practices**

In 2003, a Report on Standards and Codes by the World Bank benchmarked Mexico's observance of corporate governance practices against the OECD's Principles for Corporate Governance. According to the World Bank report and a report by the Institute of International Finance released the same year, major progress had been achieved in establishing a successful structure and culture for good corporate governance. The World Bank rated most Principles as either "largely observed" or "partially observed", indicating either only minor shortcomings or a legal and regulatory framework that complies with the Principles, but suffers from diverging practices and a lack of enforcement.

In its 2003 ROSC, the World Bank rated Mexico's observance with the sub-principles of Principle II as follows: "Basic Shareholder rights" and "Control Arrangements should be allowed to function" were rated as "Largely Observed", indicating that only minor shortcomings are noted, and that these do not raise questions about the authorities' ability and intent to achieve full observance in the short term. "Rights to participate in fundamental decisions", "Shareholder's Annual General Meeting Rights", and "Disproportionate Control Disclosure", were rated as "Partially Observed", indicating that while the legal and regulatory

framework complies with the Principle, practices and enforcement diverge. Finally, the sub-principle labeled “Cost/benefit to voting” was rated as “Materially Not Observed”, indicating that, despite progress, shortcomings are sufficient to raise doubts about the authorities’ ability to achieve observance.

The 2003 World Bank report made the following recommendations: rules blocking shares should be clarified; voting procedures for all kind of investors should be made as simple as possible; and large transactions should require shareholder approval. Also, to strengthen the rights of small shareholders, a small number of shareholders should be able to force resolutions onto the agenda and request a formal poll. A minimum interval should be established between first and second meetings, and legal provisions that define share types and rights should be simplified.

In its 2003 Corporate Governance Country Assessment of Mexico, the World Bank rated Mexico’s observance of the sub-principles of Principle III as follows: “Prohibit insider trading” was rated as “Largely Observed”, indicating that only minor shortcomings are observed which do not raise questions about the authorities’ ability and intent to achieve full observance in the short term. “Equitable treatment of shareholders” and “Board/management discloses interests” were rated as “Partially Observed”, indicating that while the legal and regulatory framework complies with the Principle, practices and enforcement diverge.

The report made a number of recommendations. In order to strengthen minority shareholder rights, the World Bank assessment team proposed the harmonization of existing thresholds at a level sufficient to allow minority shareholders to effectively exercise their rights.

In its 2003 ROSC, the World Bank rated Mexico’s observance with Principle IV as follows: “Access to Information” was rated as “Observed”, indicating that the economy has fully implemented the principle. “Legal Rights of stakeholder are respected”, “Stakeholder Redress for violation of rights”, and “Performance enhancing mechanisms” were rated as “Largely Observed”, indicating that only minor shortcomings exist, and these do not raise questions about the authorities’ ability and intent to achieve full observance in the short term.

In its 2003 ROSC, the World Bank rated Mexico’s observance with Principle V as follows: “Fair and timely dissemination” was rated as “Observed”, indicating that the economy has fully implemented the principle. “Disclosure standards” was rated as “Largely Observed”, indicating that only minor shortcomings are observed, which do not raise questions about the authorities’ ability and intent to achieve full observance in the short term. “Standards of accounting and audit” and “Independent audit annually” were rated as “Partially Observed”, indicating that while the legal and regulatory framework complies with the principle, practices and enforcement diverge.

In its 2003 Corporate Governance Country Assessment, the World Bank rated Mexico’s observance with the sub-principles of Principle VI as follows: “Access to information” was rated as “Observed”, indicating that all essential criteria are met without significant deficiencies. “Ensure compliance with law” was rated as “Largely Observed”, indicating that only minor shortcomings are observed, which do not raise questions about the authorities’ ability and intent to achieve full observance in the short term. The sub principles “Acts with due diligence and care”, “Treat all shareholders fairly”, “The board should fulfill certain key functions”, and “The board should be able to exercise objective judgment” were rated as “Partially Observed”, indicating that while the legal and regulatory framework complies with the Principle, practices and enforcement diverge.

### **3. Awareness and Advocacy for Good Corporate Governance**

Given the endorsement by APEC ministers in 2008 of the OECD Principles of Corporate Governance, this section reviews developments aimed at advancing the understanding by company and governing authority officials and the public of the OECD Principles of Corporate Governance and status of commitments to improving corporate governance in the economy.

#### **3.1 Company Directors**

There are some private bodies currently operating in Mexico, which are intended to foster corporate governance practices. However, there is no obligation for a company, public or not, to have a membership in any of these bodies. It is worth mentioning that the National Banking and Securities Commission does not endorse nor directly participate in any of these bodies. These centers or bodies offer training seminars and courses specially dealing with corporate governance issues.

#### **3.2 Media**

There are no formal educational programs aimed at building awareness of corporate governance issues.

Some specialized journals, magazines and other publications that regularly report on corporate governance issues and their developments. Corporate governance concerns have existed in Mexico for some years. The media, and also the relevant communication channels of the government or stock exchange, report on these topics any time there is something relevant or important to discuss.

#### **3.3 Educational System**

Some universities and the Mexican Stock Exchange may have formal training seminars and courses in corporate governance, but this is outside the scope of competence of the National Banking and Securities Commission. However, some universities and post graduate institutions in Mexico may be offering training in corporate governance issues.

#### **3.4 Stock Exchange**

On a regular basis the Mexican Stock Exchange offers training seminars in corporate governance. This organization also collaborates with other institutions and organizations devoted to the spread of corporate governance awareness.

### **4. Corporate Governance of State-Owned and Family-Controlled Enterprises**

#### **4.1 State-Owned Enterprises**

Since the early nineties, Mexico has followed a privatization policy, including almost all state-owned companies. In the case that the Mexican government was interested in investing in companies, it would be the Ministry of Finance and Public Credit (Secretaría de Hacienda y Crédito Público), the predominant Ministry in charge of verifying government's investment in companies. Once the investment has been made, the governing authority as for corporate governance issues, would be the corresponding "Head Ministry", e.g., for investments in the government-owned petroleum company, the Ministry of Energy.

Generally speaking, state-owned companies are subject to different norm than those applicable to private companies. This also applies to practices in corporate governance. However, the intention of the Mexican government is to improve corporate governance in state-owned companies, and align it to prevailing practices in the private sector.

For instance, the economy's petroleum company PEMEX intends to orient its corporate governance policy not only to the principles already into force in Mexico but those at the international level.

## 4.2 Family-Controlled Enterprises

The Mexican Stock Markets Law defines family controlled companies or controlling shareholders, as those shareholders who have, individually or as a group, at least 10% of the issuer's equity. In this regard, they also face limits as precluded in the most basic guidelines in terms of corporate governance. For instance, as for "Related party transactions" which are defined as transactions celebrated between the company and "related persons", which in turn are defined as "(i) any person who having control or significant influence over an entity that integrates the corporate group or group of the issuer, and the directors and relevant officers of said entities; (ii) a person with decision making authority over an entity that forms part of the corporate group or group of the issuer; (iii) spouse or family members of an individual mentioned in paragraphs (i) through (ii) herein; (iv) legal entities that integrate the corporate group or group of the issuer; (v) legal entities controlled by an individual mentioned in paragraphs (i) through (iii) herein; or (vi) legal entities over which an individual mentioned in paragraphs (i) through (iii) has significant influence".

The Mexican experience is one of important family-owned companies, and a highly concentrated market, unlike the US or some European economies. To counteract this situation, since 2006, Mexico has introduced a series of clauses and policies aimed at protecting minority shareholders, and by doing so enhance incentives to newer entrants and promote the listing of companies with more atomized capital. Mexico's legislation was amended to incorporate changes in the composition of the board and the ability to summon a general assembly by a minority.

Recent newer legislation has adapted enforcement from equity investors and from financial institutions, which in turn has meant increased pressure for nonpublic (family-owned) corporations to adopt some corporate governance best practices.

In order of preference, the following measures are being requested:

- A formal Board with some external and independent members;
- Implementation of an Audit Committee similar in composition to that requested by the Sarbanes Oxley act.
- Pressure to have a succession plan, approved by family members and/or by the controlling groups (in some instances approved by external investors and financial supporters)
- The implementation of modern internal control practices supported by much more modern and sophisticated information technology systems.
- Pressure by external auditors to use information technology as part of their auditing procedures.

## **5. Role of Professional Service Providers in Corporate Governance**

For most of the corporate governance entities (e.g., accounting firms), the principle of Materiality is followed, which is related to all qualitative or quantitative information from a corporation, its securities and the prevailing situation of the corporate group to which it belongs irrespective of the position it has within such a group, to engage in all necessary steps so as to inform all relevant agents of the real financial, administrative, economic and legal situation of the company.

For instance, pursuant to Article 28, paragraph III, section b), of the Stock Markets Law, the Board of Directors must sanction the information provided, considered as a previous opinion of the Audit/Corporate Practices Committee, as for each transaction considered as relevant, with related persons of the issuer or entities controlled by it. No approval will be necessary whenever (i) those transactions are not relevant, (ii) they are operations of the on-going business and paid at market value, and (iii) they are celebrated with employees in similar conditions as any other customer or as a result of labor benefits.

## **6. Recent Developments in Corporate Governance**

This section discusses the developments and salient issues in corporate governance in the Mexican economy during the past three years.

### **6.1 Corporate Governance Developments**

Following the approval of the new Stock Markets Law in 2006, Mexico has undergone profound reform of its corporate governance practices.

Several important changes have taken place since that time. However, the most salient changes include the following examples:

As for listed and non-listed companies, being either family-owned or foreign-owned, the need to have a formal board with some external and independent members is currently enforced. As for the composition of the board, there is now the obligation to have an Audit Committee.

“Pressure” has also been applied for applying high-tech controls like the implementation of modern internal control practices supported by modern and sophisticated information technology systems.

In relation to shareholders rights, it is voluntary for them to formally adopt either the best practices of corporate governance demanded for publicly held companies or to continue operating as before, with a “Commissary” and with no board committees but while adopting a conversion plan and with the ultimate aim of having independent board members.

Under the new legal regime for non-listed companies, all investors, controlling and non-controlling, acquire rights and obligations which allow them to have much more control and transparency than before, while allowing for a better alignment of interests among shareholders. It also creates incentives for founders and or controlling groups to attract external private equity, and for external investors to establish rules to secure their equity. These rules can be agreed and could include issues such as mergers or acquisitions, compensation or to reorient the social responsibilities of the company.

## 6.2 Enforcement of Corporate Governance Rules

The National Banking and Securities Commission is empowered to impose sanctions to public companies that do not comply with the corresponding legal framework. For example, there was the case of a public company that was involved in transactions with derivatives instruments that lost significant amounts of its financial resources. Although it is not illegal to undertake operations with this kind of instruments, the company in question was fined for not publicly informing investors and markets in general that some of its liquid assets were involved into high-risk speculative operations. Those operations should have been informed by said company, according to our legal framework, as a “relevant fact”.

This company clearly overlooked, among other things, the corporate governance principle of sufficiency and accuracy of information.

## 6.3 Current Issues and Challenges for Corporate Governance

### 6.3.1 Priorities

**1. The creation of a director training institution.** A missing ingredient in Mexico’s corporate governance reform is a director training organization (e.g., an Institute of Directors). The government (including CNBV) and the private sector have a strong interest in increasing director professionalism. International best practice suggests that the new organization can both serve as a training organization (on a fee basis) and a corporate governance advocacy organization, providing input for future corporate governance reforms. Such an institution could communicate the variety of new rules to board members and build a culture of strong and independent boards of directors.

**2. Enforcement.** The implementation and enforcement of the new corporate governance rules remain global challenges. Mexico will continue to strengthen its capacity to monitor disclosure and to enforce the corporate governance provisions of securities law. Staff should be trained to gain awareness of corporate governance issues and possible abuses. New emphasis should be placed on the disclosure of ownership, and related-party transactions. CNBV has to strengthen in practice, the technical autonomy and powers of sanctioning should be further enhanced.

Mexico still has a single-tier board structure. The updated Mexican Code of Best Practices in Corporate Governance, released in November 2006, emphasizes the functions of the board and includes a recommendation for company boards’ to issue codes of ethics and social responsibility. Although the 2006 LMV reorganizes and clarifies the duties and liabilities of the board of directors and relevant officers, the newly created committees now need to conform at least one committee which acts as an audit and corporate practices committee in a practical manner. That is the committees need to consist entirely of independent directors (with the exception of controlled companies, which may have a corporate practices committee comprised of a majority of independent directors). In this regard, the new Stock Markets Law states that failure to fulfill Duty of Care includes unjustified non-attendance to board meetings and failure to provide information relevant to decision making. However, empowering the CNBV to sanction and imprison someone engaged in the failure to comply with the duty of loyalty, which is penalized with jail time of three to 12 years if directors knowingly benefit one shareholder to the detriment of others, still needs to be addressed.

This still needs to be made applicable, in reality, for cases of conflicts of interest, or misuse of other confidential and/or relevant information.

### 6.3.2 Financial Crisis

During the recent global financial crisis, some aspects of corporate governance evidenced fragility. Perhaps, definition of value creation should not solely be linked to the volatility in the

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This still needs to be made applicable, in reality, for cases of conflicts of interest, or misuse of other confidential and/or relevant information.

### **6.3.2 Financial Crisis**

During the recent global financial crisis, some aspects of corporate governance evidenced fragility. Perhaps, definition of value creation should not solely be linked to the volatility in the price of shares but to a measure (yet unknown) of continuity of the efforts and social purpose of the company more relevant to mid- and long-term objectives.

In this respect, a formal company architecture could be redefined in terms of even more independent members of the board. The above mentioned new structure should include a more formal approach to internal committees and auxiliary bodies, as well as new company laws. These two paths should enable more committees in the compensation, risk management policy, auditing, societal practices, internal ruling, etc.

The independence of directors may not be enough. The crisis showed us that proved experience in the specific industry or sector, as well as strong analytical capacity shall always be welcome.

Last but not least, perhaps a new policy redefining the trade-off between the property and the management of companies could also be useful. For instance, in some economies, a model of members of the board composed of shareholders, versus the "classical" model of the board of executives, self-sufficient and not owners of the company, could be redesigned so as to allow for a more equal management system always in consideration of the rights of minority shareholders.

## Key Corporate Governance Rules and Practices in Mexico

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for shareholders' meetings?	X		SL	
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		SL	
3. Must company transactions with its insiders be on a non-preferential basis?	X		SL	
4. Is a super majority vote required for major company acts affecting shareholder rights?		X	SL	
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors? What percentage?	X		SL	25%
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?	X		SL	
7. Do independent directors decide what information the board receives from management?		X	SL	
8. Are the chairman of the board and chief executive officer different persons in the majority of listed companies?	X		GP	
9. Are all board members elected annually?		X	SL	
10. Does the board oversee enforcement of a company code of conduct?	X		SL	
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with International Financial Reporting Standards (IFRS)?		X	SL	
12. Are the identities of the five largest shareholders disclosed?	X		SL	
13. Is compensation of company executive officers disclosed?		X	GP	
14. Are extraordinary corporate events disclosed?	X		SL	
15. Are risk factors disclosed in securities offering materials?	X		SL	
16. Are transactions of a company with its insiders disclosed?	X		SL; GP	Depending on the nature of the transaction and/or whether or not it takes place as a related-party transaction.

Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory

# New Zealand

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in New Zealand

#### 1.1 Background

The basis for New Zealand's corporate governance system is set out in the following laws:

***Companies Act 1993:*** this Act describes the basic requirements for incorporating, organising, and operating companies. It defines the relationships between companies, directors and shareholders, sets out the duties of directors and provides for the protection of shareholders and creditors against the misuse of management powers. It provides procedures for realising and distributing the assets of insolvent companies. It also outlines the powers and duties of the Registrar of Companies (ROC), which include registering and inspecting documents.

***Securities Act 1978:*** this Act establishes the Securities Commission, defines its powers and functions, regulates the offer of securities to the public for subscription and confers on ROC the responsibility of registering prospectuses and associated documents for the offer of securities to the public. The term security is widely defined and covers equities, debt securities including bank and finance company deposits as well as corporate and other bonds, interests in partnerships and syndicates, interests in unit trusts, life insurance policies with an investment component, and interests in superannuation schemes.

***Securities Markets Act 1988:*** this Act regulates various activities on securities markets including insider trading and market manipulation. It provides a statutory framework for continuous disclosure by public issuers, substantial security holder disclosure, disclosure of dealings by directors and officers of public issuers, registration of stock exchanges, and dealings in futures contracts including the authorisation of futures exchanges. It confers on the Securities Commission the power to regulate in these areas.

The Securities Commission issued a set of corporate governance principles and guidelines in 2004 following a public consultation process that showed significant support for a principles-based approach to corporate governance. The principles cover: ethical standards, board composition and performance, board committees, reporting and disclosure, remuneration, risk management, auditors, shareholder relations and stakeholder interests.

New Zealand Exchange Limited, NZX, the only regulated securities exchange, demutualized in late 2002, and self-listed in 2003. The NZX listing rules set corporate governance standards for issuers listed on the exchange. The listing rules include corporate governance standards such as requirements for appointment of directors, remuneration of directors, transactions with related parties and major transactions. One third of directors must be independent directors and every issuer must have an audit committee which must have a majority of members that are independent directors.

## 1.2 Trends

Year	2005	2006	2007	2008	2009
Number of listed companies	153	151	152	147	143
Domestic market capitalisation (US\$ million)	40,592.5	44,816.5	47,485.6	24,209.6	35,306.8

Domestic market capitalisation peaked in May 2007, and fell to a low of US\$20 billion in February 2009. Stock prices and capitalisation have improved since. The number of listed companies, previously stable, declined slightly over the past two years.

## 1.3 Key Corporate Governance Rules and Practices

See Key Corporate Governance Rules and Practices in New Zealand, p. 167.

# 2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules

## 2.1 Development of Corporate Governance Rules

The Ministry of Economic Development has the role of advising the government on corporate governance policy and implementing changes to corporate governance laws and regulations.

The Securities Commission has a role in encouraging good corporate governance. At the request of the Minister of Commerce, the Commission developed and issued a set of corporate governance principles in 2004. The Commission was assisted by other work done in New Zealand, in particular by New Zealand Exchange Limited, the Institute of Directors in New Zealand, and the Institute of Chartered Accountants of New Zealand. The commission reviews a sample of issuers' annual reports and assesses them against the principles. The commission's review aims to assess the current level and quality of disclosure and provide useful feedback to the market.

NZX develops its listing rules. Any new rules or changes to existing rules are submitted to the Minister of Commerce, who can disallow the proposed rule or change where it is in the public interest to do so.

## 2.2 Enforcement of Corporate Governance Rules

The National Enforcement Unit (NEU) of the Ministry of Economic Development is responsible for ensuring that New Zealand's financial and commercial institutions are effectively monitored and that business regulations are enforced. The NEU investigates and, where appropriate, prosecutes offences under various legislation on behalf of the ROC. The NEU also assesses and determines whether candidates should be prohibited from being directors of a company under section 385 of the Companies Act 1993.

In 2009, six companies were delisted from the NZX, and in 2008, seven companies were delisted. It is not known how many of these were for failure to comply with corporate governance rules. NZX referred 13 matters relating to compliance with insider trading, substantial security holder, and continuous disclosure provisions to the Securities Commission in 2009.

In 2008-09 the Securities Commission filed civil and criminal proceedings against directors of two companies in receivership, alleging that directors misled investors by making untrue statements in their companies' offer documents.

### **2.3 Assessment of Corporate Governance Practices**

New Zealand has not been subject to a ROSC assessment with respect to observance of the OECD Principles of Corporate Governance.

## **3. Awareness and Advocacy for Good Corporate Governance**

### **3.1 Company Directors**

The Institute of Directors in New Zealand (Inc.) promotes excellence in corporate governance, represents directors' interests and facilitates their professional development through education and training. It is a membership organisation of around 4,700 individuals representing the spectrum of New Zealand enterprise, from the public and private sectors. The Institute offers a range of courses in corporate governance for company directors.

### **3.2 Media**

There are often articles in the financial press which comment on corporate governance issues. Examples of recent topics are:

- The performance of directors in the collapse of a number of finance companies;
- Directors' workloads—are they taking on too many directorships and hence not devoting enough time and effort to each;
- Representation of women on boards; and
- Whether a lack of ethics by directors is a contributing factor to investors' reluctance to invest in capital markets.

### **3.3 Educational System**

Tertiary education courses in business and law include corporate governance topics.

Corporate governance courses are available in programs for MBA and other advanced business degrees.

## **4. Corporate Governance of State-Owned and Family-Controlled Enterprises**

### **4.1 State-Owned Enterprises**

The Crown Ownership Monitoring Unit (COMU) within the Treasury monitors the state's investments in companies.

COMU:

- Provides strategic ownership advice to the New Zealand government on the commercial assets it owns and monitors the performance of those assets;
- Assists with the appointment of directors to Crown company boards;
- Advises shareholding Ministers on performance and governance issues; and

- Works with other monitoring departments and agencies to share good practice and lift performance.

COMU monitors the following entities:

- 17 state-owned enterprises;
- Eight Crown research institutes;
- Four Crown financial institutions;
- Air New Zealand Limited;
- Five other Crown companies;
- Some statutory entities; and
- The Crown's shareholding in a shipping line and four airports.

The establishing Acts for the companies owned by the Crown set out some additional requirements. For example, the State-Owned Enterprises Act 1986 requires each SOE to annually submit a Statement of Corporate Intent (SCI), which in part sets out the objectives of the SOE, and the nature and scope of its activities. SOEs are required to make all decisions in accordance with their SCI.

The Crown expects all SOEs to act in accordance with best practice corporate governance principles, including, for example, the observation of high ethical standards and the effective management of any conflicts of interest. The principal objective of every SOE, as per its establishing Act, is to operate as a successful business and to this end, to be as profitable and efficient as comparable businesses that are not owned by the Crown.

The OECD undertook a survey of OECD economies and the results were favourable for NZ and its ownership model. The survey considered all aspects of the guidelines including the ownership function, relationship of SOEs with shareholders, transparency and governance.

## **4.2 Family-Controlled Enterprises**

The majority of large New Zealand-controlled firms are listed on the stock exchange. Many private companies, including family-owned businesses, lack good governance structures (such as external board members). Governance and compliance costs are likely to be factors deterring them from becoming listed companies.

# **5. The Role of Professional Service Providers in Corporate Governance**

## **Accounting and auditing firms**

The directors of the company are responsible for preparing financial statements which give a true and fair view of the financial position of the company, the results of its operations and cash flows for the accounting period. The financial statements must be prepared in accordance with International Financial Reporting Standards (IFRS).

Auditors are required to express an independent opinion on the financial statements stating whether:

- Proper accounting records have been kept;
- The financial statements:

- comply with IFRS;
- comply with New Zealand generally accepted accounting practice; and
- give a true and fair view.

### **Professional bodies**

Professional bodies such as the New Zealand Institute of Chartered Accountants and the New Zealand Law Society, and industry bodies, such as the New Zealand Institute of Directors and the Listed Companies Association are important stakeholder organizations in consultation during the corporate governance policy development process.

## **6. Recent Developments in Corporate Governance**

### **6.1 Corporate Governance Developments**

*Reform of the minority buy-out provisions of the Companies Act 1993:* A Bill was enacted in 2008 aimed at clarifying and improving the efficiency of provisions requiring companies to buy-back the shares of minority shareholders in the event of a transaction that fundamentally changes the nature of the company or its business.

*Enactment of the Limited Partnerships Act 2008:* On 2 May 2008 the Limited Partnerships Act 2008 came into force. This Act provides for the establishment of the new legal form of limited partnership, whose key features include flow-through tax status; limited liability for investing partners and separate legal personality. The primary objective of the introduction of the Limited Partnerships regime is to facilitate sustainable growth in New Zealand's venture capital and private equity industries.

### **6.2 Enforcement of Corporate Governance Rules**

A number of company directors are being taken to Court by the Registrar for breaches of the Companies Act, following from the collapse of around 30 finance companies in New Zealand over the last three years. One person has been convicted for the provision of misleading information in a prospectus and filing reports containing false information in the 2009-10 year. Other cases are still before the courts.

In 2010 the Securities Commission has initiated two separate cases of civil and criminal proceedings under the Securities Act against finance company directors for making false statements in offer documents. Similar proceedings were filed in 2008 against directors of two companies. The Commission has also filed civil proceedings in 2010 against a company and its directors for a breach of continuous disclosure obligations.

The New Zealand Markets Disciplinary Tribunal, which is an independent body responsible for hearing and determining matters referred to it in relation to the conduct of parties regulated by the NZX Participant Rules and NZX Listing Rules, in 2009 considered four cases concerning breach of periodic reporting requirements, noting that this was a significant increase in number from previous years.

### **6.3 Current Issues and Challenges for Corporate Governance**

#### **6.3.1 Challenges**

The collapse of finance companies referred to above has led to media comment on the role of prominent people (such as former politicians) taking up directorships on companies that have

subsequently failed. Investors in these companies have suffered significant losses and have questioned the qualifications and judgment of such directors.

### **6.3.2 Priorities for Reform**

A major concern for the government has been to rebuild the trust of investors in capital markets, and to develop New Zealand's capital markets to allow for business growth while ensuring that investors get proper levels of protection.

The New Zealand government has begun the process of establishing a new regulator for New Zealand's financial markets, to be called the Financial Markets Authority (FMA). The FMA will take over all the work of the Securities Commission. It will enforce securities, financial reporting, and company law as they apply to financial services and securities markets. It will also regulate and oversee, trustees, auditors, financial advisers and financial service providers, including people who offer investments. Legislation establishing the FMA will be passed in 2010 year, and it will be operating early in 2011.

A further priority is to complete the Review of the Financial Reporting Framework. The review aims to achieve a framework that is appropriate for all types of entities and is enduring. The government has made a decision to consolidate all accounting and auditing standards setting responsibilities within a new government standard setting agency. Further issues being considered are whether to remove preparation requirements for small and medium companies, and how to rationalise the reporting requirements in the non-profit sector. Legislation to implement the review is intended to be introduced into Parliament in 2011.

Following the collapse of a significant number of corporations internationally, many governments concluded that self-regulation of the audit profession was no longer appropriate and introduced government regulation, independent oversight or a combination of the two. New Zealand currently relies on self-regulation, but in light of the risk that New Zealand auditors are de-recognised overseas, decisions have been taken to strengthen auditor regulation. Audit standards will be set by a government regulator, and there will be government oversight of the licensing of auditors. The reforms are due to be implemented in 2011.

### **6.3.3 Financial Crisis**

The move to a consolidated financial sector regulator for capital markets draws on the lessons from the financial crisis and aims to restore investor confidence in financial markets.

In addition a review being led by the Ministry of Economic Development aims to ensure that securities regulation keeps up with changes in the financial environment. A key part of the review will be to take into account lessons from the international credit crisis and to stay closely linked into international regulatory developments. The review encompasses the application of securities legislation, the form and content of required disclosure, supervisory and regulatory controls, and compliance with international principles.

## Key Corporate Governance Rules and Practices in New Zealand

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for shareholders' meetings?	X		CL	
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		GP	
3. Must company transactions with its insiders be on a non-preferential basis?	X		CL	Companies may avoid a transaction in which a director is interested unless the company has received fair value for it.
4. Is a super majority vote required for major company acts affecting shareholder rights?	X		CL	75% majority required.
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors? What percentage?	X		SLR	One third of directors (rounded down to the nearest whole number) must be independent.
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?	X		CGC, SLR	This is contained in the principles issued by the Securities Commission.
7. Do independent directors decide what information the board receives from management?		X		
8. Are the chairman of the board and chief executive officer different persons in the majority of listed companies?	X		GP	
9. Are all board members elected annually?		X		
10. Does the board oversee enforcement of a company code of conduct?		X	CGC	This is contained in the principles issued by the Securities Commission.
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with IFRS International Financial Reporting Standards (IFRS)?	X		Financial reporting law	The Accounting Standards Review Board requires issuers to comply with IFRS.
12. Are the identities of the five largest shareholders disclosed?	X		CL	
13. Is compensation of company executive officers disclosed?	X		CL	The number of employees in brackets of \$10,000 receiving remuneration above a threshold of \$100,000 per annum must be disclosed.
14. Are extraordinary corporate events disclosed?	X		CL	Major transactions must be disclosed to shareholders and approved by special resolution, i.e. 75% majority.
15. Are risk factors disclosed in securities offering materials?	X		SL	
16. Are transactions of a company with its insiders disclosed?	X		CL	Directors must disclose their interest in any transaction with the company.

Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory

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# Peru

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in Peru

#### 1.1 Background

The General Corporation Law sets the guidelines about governing the organization of the economy's enterprises. In addition, the companies that participate in the public securities market are subject to the transparency requirements of the Securities Market Law (L.D. No861).

In July 2002, the Principles of Good Governance for Peruvian companies were published. This document included the participation of CONASEV, the National Supervisory Commission for Companies and securities, the Lima Stock Exchange and other organizations interested in the developments and discussions related to the societies' good corporate governance. The goal was "to make Peruvian companies reach international standards", as well as offering greater confidence to local and foreign investors, especially to the minority shareholder.

The document included the five most important principles recommended by the Organization for Economic Cooperation and Development OECD for Latin America, as well as the Peruvian society's characteristics in relation to their shareholder structure and the legal framework in which they develop.

The publication of the Principles of Good Governance for Peruvian companies was intended to establish guidelines in order to promote a culture of good practices within organizations.

In December 2003, CONASEV issued the General Management Rule N° 096-2003-EF/94.11, whereby societies with registered securities at the Public Security Market Registry are obliged to inform to the market about the scale of implementation of the 26 principles. To this date, CONASEV has issued reports about the accomplishment of the Principles of Good Governance for the years 2005, 2006, 2007 and 2008.

#### 1.2 Trends

	2005	2006	2007	2008	2009
Capitalization (US\$ million)	36,196	60,020	108,220	57,231	107,325
Issuers with variable rate securities listed at the Lima Stock Market	231	235	232	231	254

#### 1.3 Key Corporate Governance Rules and Practices

See Key Corporate Governance Rules and Practices in Peru's Economy, p. 173.

# Development, Enforcement and Assessment of Implementation of Corporate Governance Rules

## 2.1 Development of Corporate Governance Rules<sup>85</sup>

In Peru's economy, there are two main institutions responsible for the implementation of regulations related to the enterprises' corporate governance. These are CONASEV and the Superintendency of Banking, Insurance and Private Pension Funds Administrators.

Besides regulating the above, CONASEV requires the issuer companies with registered securities at the Public Security Market Registry (RPMV) to hand in together with their Annual Report, an Annex entitled "Information about the Accomplishment of the Principles of Good Governance for Peruvian Companies". CONASEV issues a summary annually, including the declared information on its website.

CONASEV's annual report identifies areas of improvement for corporate governance, thereby promoting adherence to the implementation of CG principles.

The Superintendency of Banking, Insurance and Private Pension Funds Administrators (SBS) is the body responsible for regulating and supervising the financial, insurance and administrators' private pension funds market. Through various policy measures the SBS incentivizes good corporate governance practices for companies in the private pension system. The Superintendent's Compendium of Regulatory Standards of the Private Pension Fund Administrator System has been established to encourage good corporate governance practices, including in those societies that invest in managed portfolios.

## 2.2 Enforcement of Corporate Governance Rules

CONASEV's regulation is based on the obligations of societies registered in the Public Securities Registry to provide the market with regular and timely information. In addition, CONASEV has the authority to call a general assembly or a special shareholder meeting, if the company does not fulfill its obligations according to the law or the company's statutes.

In 2008, CONASEV imposed 104 penalties, and slightly more in 2009 (106). Furthermore, the number of complaints lodged with the respective administrative court statement and prompted by investors and by CONASEV was 378 in 2008 and 253 in 2009.

There are no cases in which companies have been delisted for failing to comply with good corporate governance.

## 2.3 Assessment of Corporate Governance Practices

Each year, CONASEV issues a report regarding adherence to the principles of good corporate governance by companies in Peru. In the 2009 report, 10 principles were examined, 14 deeply examined, one was partially examined, and one was materially not examined. A modification in the questionnaire to make more specific the display of breaches is being undertaken.

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<sup>85</sup> "Rules" refers to requirements for corporate governance however they are designated; e.g., laws, regulations, stock exchange listing requirements, or principles in obligatory codes.

## **3. Awareness and Advocacy for Good Corporate Governance**

### **3.1 Company Directors**

In Peru, Procapitales is a private-sector entity that seeks to contribute to the development of the Peruvian capital market. It has a Corporate Governance Committee, which aim is to promote and disseminate the concepts and benefits of good corporate governance, in order for companies to adopt these good practices. One important activity of this Committee is the Competition of Good Corporate Governance. In this way, the directors of the most important companies of the economy can obtain the benefits from the Good Corporate Governance implementation. Procapitales has 69 partners, including stock brokers, audit firms, fund administrators, securitization firm, universities and law firms.

The securities market regulator organizes workshops for the company's directors listed on the stock exchange, in order to comply, adequately, with the requirement of disseminating the accomplishment of the principles of good corporate governance. This dissemination is held through a survey that belongs to the annual report of the issuer.

### **3.2 Media**

CONASEV proactively interacts with the media, in order to promote the securities market and to inform the public about the new regulations. The compliance with the Principles of Good Corporate Governance is one of the several topics to be promoted. Among the financial press, the issue of corporate management is extremely important.

### **3.3 Educational System**

Topics about corporate governance are mainly addressed by universities, and in professional training. It is not mandatory on the high school syllabus.

At a postgraduate level, especially in relation to Masters of Business Administration degree courses (MBA), this topic is addressed, given the need for minority shareholders protection and transparency in the management of the company, among other CG issues.

In the judicial scope, the judges have commercial expertise but are not specialized in good corporate governance.

### **3.4 Stock Exchange**

The Lima Stock Exchange, although not delegated with any regulatory function, is developing various practices to boost corporate governance. Thus, the Lima Stock Exchange has created the Corporate Governance Index (IBCG) in order to identify the companies that best apply these principles. Each year, the stock market recognizes companies that obtain the highest scores on the rating of Principles of Good Corporate Governance.

## **4. Corporate Governance of State-Owned and Family-Controlled Enterprises**

### **4.1 State-Owned Enterprises**

The National Fund for the Financing of State Entrepreneurial Activities (FONAFE) is the entity responsible of regulating and directing the commercial activity of the State. Under its purview are companies with a majority state participation, whether such companies are active or in the

process of liquidation. There are also under its area, the companies that have been delivered to them by request.

The companies that are controlled by the State have the same corporate governance requirements as the private sector. There are no important issues of corporate governance, regarding the way in which companies with majority public ownership are governed. All state companies with listed securities obey corporate governance guidelines.

## **4.2 Family-Controlled Enterprises**

Among family-owned businesses, it appears that there is very limited participation of independent directors and that there are problems with the transactions between related companies.

The main disincentives are the costs associated with CG. To the extent that companies develop more and consider the advantages of participating in the market, this pattern must change.

# **5. Role of Professional Service Providers in Corporate Governance**

None of the professional service providers has a role to inform their clients about corporate governance.

# **6. Recent Developments in Corporate Governance**

## **6.1 Corporate Governance Developments**

The main contributions of the amendments to the Securities Market Law related to Good Corporate Governance are as follows:

Regarding the Rights of Minority Shareholders:

A company's shareholders representing at least 25% of the share capital may request registration of its shares in the Public Security Market Registry from CONASEV, creating a new type of shares. Thus, the minority shareholders can access the secondary market and get a better price for their shares.

The Article 21-A (vote by e-mail or post), which was included in the General Corporation Law (LGS), stipulates that shareholders or members may exercise their right to vote by electronic means to determine the quorum, the vote and establishment of agreements. Procedurally, a digital signature (when submission is by e-mail) or legalized signature (when submission is by post) are required.

This remedy was implemented so that members can discuss a society's issues and approve agreements without meeting face to face, thereby providing them the possibility to reduce operating costs, especially for those companies that have a significant number of shareholders or those that usually list their shares on the Stock Exchange.

In the LGS, CONASEV is the only body competent to call a general assembly of shareholders, when this has been denied by the society, or when the legal deadline is overdue, or when the board has called a general assembly with insufficient notice. The applications for a plea require 5% of the registered shares entitled to vote.

The 262-A Article was included in the LGS (minority shareholders protection procedure) and establishes that an Anonymous Society is not obliged to publish in El Peruano, the official economy-wide newspaper and its website, the total number of unclaimed shares and their total value, the total amount of uncashed dividends, the list of shareholders that have not claimed their shares and/or dividends. It is sufficient to publish this information on the society's website and the Securities Market website.

## 6.2 Enforcement of Corporate Governance Rules

On 22 July 2010, the members of the Investors Committee in an institutional investor were punished, as well as the employees of a stock broking company because the securities buyers used privileged information.

On 22 July 2010, a bank was punished because it did not submit its financial information on time.

The typical cases involving punishment by CONASEV are related to the lack of timely regular information.

## 6.3 Current Issues and Challenges for Corporate Governance

### 6.3.1 Challenges

The main challenge is to improve the perception of both issuers and investors about the benefits of achieving good corporate governance accomplishment.

### 6.3.2 Priorities for Reform

The priorities are to improve the rules on the use and abuse of the privileged information and the price manipulation, so it can allow the institution to have all the necessary tools in order to apply the appropriate penalties.

We will continue to study the good corporate governance among Peruvian companies. There are not any priorities about the enforcement.

In relation to the protection of the minority shareholders' rights, there will be continued efforts to improve current rules and monitoring methods.

### 6.3.3 Financial Crisis

CONASEV is studying the new international regulatory controls that have come about as a consequence of the subprime crisis in the US, with the aim of evaluating their possible application in the local market.

## Key Corporate Governance Rules and Practices in Peru's Economy

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for shareholders' meetings?		X		Normally, the board of directors is responsible for preparing the agenda.
2. Do shareholders ask questions of directors at shareholders' meetings and do	X		CL	They can always ask, if the questions are related to the agenda.

Element	Yes	No	Source(s) of Rule	Comments
they receive answers?				
3. Must company transactions with its insiders be on a non-preferential basis?	X		SL	The people with access to privileged information are being monitored.
4. Is a super majority vote required for major company acts affecting shareholder rights?	X		CL	The General Corporation Law requires shareholder majority of two-thirds of the voting capital; however the companies' statutes can mandate a higher proportion. Business decisions affected by this requirement are the following: <ul style="list-style-type: none"> <li>• Amendment of Statutes</li> <li>• Increase or decrease in the share capital</li> <li>• Alienation, in one transaction, of the assets that have a book value more than 50% of the capital</li> <li>• The transformation, merger, division, reorganization and dissolution of the society, as well as its termination</li> </ul>
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors? What percentage?	X		CL	For companies in the non-financial sector, this is up to each of them. In the case of Banks, Insurance Companies and Private Funds Administrators, at least one independent director is required.
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?				For companies in the non-financial sector, this depends on the decision of each. In the case of banks, insurance companies and private funds administrators, it has been established by the regulator's general law that it has to be at least one independent director in the Audit Committee.
7. Do independent directors decide what information the board receives from management?		X		The independent directors in agreement with the other directors decide what information to receive.
8. Are the chairman of the board and chief executive officer different persons in the majority of listed companies?	X		CL	
9. Are all board members elected annually?		X	CL	Depends on each company's decision.
10. Does the board oversee enforcement of a company code of conduct?	X		CL	Depends on each company's decision.
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with International Financial Reporting Standards (IFRS)?	X		SL	Normal.
12. Are the identities of the five largest shareholders disclosed?	X		SL	Normal.
13. Is compensation of company executive officers disclosed?		X	CL	
14. Are extraordinary corporate events disclosed?	X		SL	Normal.
15. Are risk factors disclosed in securities offering materials?	X		SL	Normal.
16. Are transactions of a company with its insiders disclosed?	X		SL	Normal.

Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory

# Philippines

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in the Philippines

#### 1.1 Background

There are four external influences on Philippine Corporate Governance

- The legal system
- The regulatory system
- The judicial system
- Financial reporting standards

The legal system as an external influence includes such laws as the Corporation Code, the Securities Regulation Code (SRC), the General Banking Act and the New Central Bank Act. The regulatory system encompasses rules and regulations issued by agencies that regulate corporate entities [Securities and Exchange Commission (SEC)]; publicly listed firms [SEC/Philippine Stock Exchange (PSE)] and financial institutions [SEC/Bangko Sentral ng Pilipinas (BSP)]. These rules and regulations have influenced corporate governance reforms.

Under Republic Act (R.A.) 7653 (New Central Bank Act, 10 June 1993), the BSP shall have supervision over the operations of banks and exercise such regulatory powers as provided in the law. On 12 April 2000 R.A. 8791 (General Banking Act) was passed into law to regulate the organization and operations of banks, quasi-banks and trust entities. Some of its provisions related to corporate governance are as follows:

- Restriction on bank exposure of directors, officers, stockholders and their related interests (DOSRI);
- Review by the Monetary Board of the qualifications and disqualifications of Individuals elected or appointed bank directors and officers;
- Prescribe at least five and maximum of 15 directors, two of whom shall be independent directors; and
- Disclosure of transactions with the bank by family groups and related interests.

The PSE provides the market for the trading of securities. In June 1998, the SEC granted PSE a Self-Regulatory Organization status, authorizing it to impose rules and penalties on erring trading participants and listed companies.

The SRC was enacted into law on 8 August 2000. One of the objectives of the SRC is to encourage the widest participation of ownership in enterprises. The SRC incorporates and modified certain provisions of the Revised Securities Act of 1982 and the earlier Securities Act of 1937. The SRC was patterned after the 1933 US Securities Act and the 1934 US Securities

Exchange Act. For the protection of investors, SRC requires the filing of annual reports and periodic reports necessary to update investors on its business operation.

Under R.A. 799 or the SRC, the Philippine judiciary is now vested with original jurisdiction to hear cases that were used to be resolved by the SEC. Decisions of the Regional Trial Courts are appealable to the Court of Appeals (CA) and all cases decided by the CA can be brought to the Supreme Court for final review. The following are cases covered by the Philippine judiciary:

- Devices or schemes employed by or any acts, of the board of directors, business associates, its officers or partnership, amounting to fraud and misrepresentation which may be detrimental to the interest of the public and/or of the stockholder, partners, members of associations or organizations registered with the Commission;
- Controversies arising out of intra-corporate or partnership relations, between and among stockholders, members, or associates; between any or all of them and the corporation, partnership or association of which they are stockholders, members or associates, respectively; and between such corporation, partnership or association and the state insofar as it concerns their individual franchise or right to exist as such entity; and
- Controversies in the election or appointments of directors, trustees, officers or managers of such corporations, partnerships or associations.
- Claims for profits on transactions of directors, officers and principal stockholders who own more than 10% of any class or equity realized from unfair use of information obtained as owner/director within any period of less than six months.

Financial Reporting Standards are set by the Generally Accepted Accounting Principles (GAAP). According to SRC Rule 68, GAAP represents accounting principles that are promulgated by the following:

- SEC
- Financial Reporting Standards Council
- Standards issued by the International Financial Reporting Standards Board
- Accounting Principles and Practices

## 1.2 Trends

	2005	2006	2007	2008	2009
No. of Listed Companies (Year end)	236	239	244	246	248
Market Capitalization* (billion pesos)	5,948.74	7,173.19	7,977.61	4,069.23	6,029.08

*Source: PSE Annual Report for 2009*

The number of listed domestic companies rose from 234 in 2005 to 246 in 2009. The market capitalization of domestic firms reached P3.99 trillion in 2009, 61.35% higher than its 2008 level. However, this was still lower than the P4.27 trillion recorded in 2007. Total market capitalization including those of foreign corporations rose by 48.16% compared to its 2008 level. The financial sector had the biggest share of market capitalization in 2009 accounting for 43.2% of the aggregate value.

## 1.3 Key Corporate Governance Rules and Practices

See Key Corporate Governance Rules and Practices in the Philippines, p. 182.

## 2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules

### 2.1 Development of Corporate Governance Rules

The SEC, BSP and the Insurance Commission (IC) are the principal regulatory agencies that promote corporate governance rules in the Philippines. In the private sector, institutions like the PSE and the Institute of Corporate Directors (ICD) play significant roles.

Pursuant to its mandate under the SRC and in accordance with the State's policy to actively promote corporate governance reforms designed to raise investor confidence, develop capital market and help achieve high sustained growth for the corporate sector and the economy, the SEC, in its Resolution No.135, Series of 2002 dated 4 April 2002, approved the promulgation and implementation of the Code of Corporate Governance, which shall be applicable to corporations whose securities are registered or listed, corporations which are grantees of permits/licenses and secondary franchise from the Commission and public companies. This Code also applies to branches or subsidiaries of foreign corporations operating in the Philippines whose securities are registered or listed. The Commission, in its meeting on 18 June 2009, subsequently revised the Code which became effective on 15 July 2009.

### 2.2 Enforcement of Corporate Governance Rules

The implementation of good corporate governance in the Philippines is the responsibility of three agencies: (a) BSP for the banking sector; (b) SEC for the non-bank financial institutions; and IC for the insurance companies. Each of these three regulators has issued rules for its covered entities. In case of non-compliance, the regulators can impose sanctions that include monetary penalties or revocation of registration.

In line with the program to promote good corporate governance, and towards a fair and efficient market, the PSE continues to enforce the Disclosure Rules among the listed companies. At the same time, the PSE strengthened its campaign to inform the listed companies about the proper observance of Disclosure Rules. In 2008, the total number of violations penalized for non-compliance of structured reportorial requirements increased by 11.3% compared to its 2007 level. However, the total number of cases penalized for non-compliance of unstructured reportorial requirements penalized decreased by 9.6% from its level in 2007.

#### Summary of Violations and Penalties

Violations	No. of Cases	Amount in P million
Structured		
Annual	30	2.142
Quarterly	29	1.274
Unstructured	47	2,613
Total	106	6.029

*Source: PSE Annual Report for 2008*

The PSE is in the process of revisiting the revised Disclosure Rules, with the proposed revisions targeted to be elevated to the SEC in 2010.

## 2.3 Assessment of Corporate Governance Practices

The World Bank Report on the Observance of Standards and Codes [World Bank: 2007] shows that in 2006, the Philippines was partially observing the standards and codes in most corporate governance categories. The table below summarizes this assessment:

CG Category	Finding	Manifestations
Equitable treatment of shareholders	Partially observed	Shareholders have a facility for seeking redress; insider trading is regulated
Disclosure and transparency	Partially observed	Board and management are compliant with disclosure requirements; most of the standards in accounting and auditing are consistent with international standards
Rights of shareholders	Largely observed	Basic shareholders' rights are largely observed; shareholders participate in annual general membership meetings and are allowed to consult with management usually through the Corporate Secretary
Role of shareholders	Partially observed	Stakeholders' legal rights are largely observed while both stakeholder redress and disclosure are partially observed; weak in whistleblower protection and creditors' rights, law and enforcement
Board responsibility	Partially observed	Procedures and mechanisms are partially observed

## 3. Awareness and Advocacy for Good Corporate Governance

### 3.1 Company Directors

The Philippine ICD is a non-stock, not-for-profit organization working in close partnership with other business, government, and civil society organizations to promote and uphold the practice of good corporate governance among Philippine Corporations such as publicly-listed companies (PLCs), universal and commercial banks, state-owned enterprise or the Government Owned and Controlled Corporations (GOCCs) and Family-owned corporations (FOCCs).

The ICD is made up mainly of individual corporate directors and reputational agents committed to the professional practice of corporate directorship in the Philippines in line with global principles of modern corporate governance. ICD is working closely with the Organisation for Economic Cooperation and Development (OECD), the Global Corporate Governance Forum, and the International Corporate Governance Network on improving actual boardroom practices: moving away from principles into actual practices.

The ICD is a professional organization of, for, and by corporate directors and other reputational agents for corporate governance. Its mission is

- To attend to the professional needs of corporate directors directly related to their serving on a board of directors.
- To raise the standards for the professional practice of corporate directorship, and to work with partners in a joint pursuit of systemic corporate governance reforms in the Philippines and the East Asian region.
- To accredit corporate directors committed to enhancing the long-term value of the corporation they serve through the observance of corporate governance principles, ethics and social responsibility.

The regulatory bodies: the SEC, the BSP and the IC require that a director must undergo the Corporate Governance Training Program before he/she will be qualified to sit on the board. The ICD and other educational institutions accredited by the regulators offer such training.

Continuing corporate governance education is optional. The ICD offers a professional directorship program and an advanced corporate governance training program in which directors can become ICD Fellows and as such become part of the body that promotes good corporate governance among Philippine corporations. ICD Fellows meet every month at a breakfast roundtable to discuss current issues on corporate governance, providing additional continuing education for participants.

### **3.2 Media**

The PSE and the ICD conducts/sponsors lectures for the media on Corporate Governance. There are no regular reports on corporate governance issues. Reporting is dependent on the personalities involved or the actual issues.

### **Educational System**

The Commission on Higher Education (CHED) is revising the curriculum of some tertiary courses (e.g., Business Administration, etc.) to include subjects on corporate governance and corporate social responsibility. The CHED is the governing body covering both public and private higher education institutions as well as degree-granting programs in all tertiary educational institutions in the Philippines. Established through Republic Act 7722 or the Higher Education Act of 1994, CHED is mandated, among other things, to promote quality education, and ensure the advancement of learning and research, the development of responsible and effective leadership, and the education of capable professionals.

Corporate Governance and Corporate Social Responsibility is a core subject in the MBA program.

### **3.4 The Stock Exchange**

The PSE has programs in support of good governance. One is the conduct of the annual scorecard survey among listed companies, in cooperation with the SEC and the ICD. This serves as a tool for market participants and investors to evaluate the companies' governance practices.

## **4. Corporate Governance of State-Owned and Family-Controlled Enterprises**

### **4.1 State-Owned Enterprises**

The Department of Justice through the Office of the Government Corporate Counsel is the governing authority for government corporations.

Most government corporations have their own supervisory agency as stated in their respective charters. These "mother" agencies may prescribe the adoption of good governance rules. The SEC has issued a general code of corporate governance which may serve as a model for corporations when they register with the SEC.

In 2006, five GOCCs, viz, Development Bank of the Philippines, Philippine Deposit and Insurance Corporation, Philippine Export-Import Credit Agency, Landbank of the Philippines, and the National Transmission Corporation got the highest scores among 31 GOCCs in the Corporate Governance Scorecard (CGS) conducted by the ICD. The conduct of the CGS was in recognition of the sentiments expressed by many sectors in the economy that GOCCs and Government Financial Institutions (GFIs) should help set the tone for improved governance practices. The scorecard created by ICD for GOCCs and GFIs is in accordance with the OECD

Guidelines on Corporate Governance of State-owned Enterprises (SOEs). Five major concerns of corporate governance in SOEs are covered such as ensuring an effective legal and regulatory framework for SOEs, the State acting as an Owner, relations with stakeholders, transparency and disclosure, and the responsibilities of the boards of SOEs.

#### **4.2 Family-Controlled Enterprises**

Studies show that the ownership structure in the Philippines is dominated by a few families and individuals. The general public is not a significant investor in the stock market. Family controlled corporations or close corporations must follow the SEC rules on corporate governance. There is no empirical basis to say that family owned corporations consider corporate governance requirements as a disincentive to public listing. Recent research study showed that corporate governance positively influences the financial performance of listed companies in the Philippines.

### **5. Role of Professional Service Providers in Corporate Governance**

#### **Accounting and Auditing firms**

Accounting and audit firms provide the public with an objective, independent opinion about the financial position and performance of the companies. They review financial statements in order to determine whether such statements reflect the true financial position of the company.

#### **Rating agencies**

A credit rating agency assigns credit ratings for issuers of debt instruments. A credit rating for an issuer takes into consideration the issuer's, and affects the interest rate applied to the particular security being issued.

The value of such ratings is given much weight by the public and is an important factor in the decision to invest.

#### **Commercial banks**

Commercial banks offer a wide range of corporate financial services that address the specific needs of private enterprise. They provide deposit, loan and trading facilities, among others. They remain to be the major source of funding for businesses.

#### **Securities analysts**

The reports and recommendations made by securities analyst are often used by traders, mutual fund managers, portfolio managers and investors in their decision making processes.

#### **Law firms**

Law firms give advice to market participants (issuer, underwriter, fund manager, investors, etc.) and provide opinion on the legality of the issuance and enforceability of the contract and agreements entered into by the parties.

#### **Corporate governance consultants**

Corporate governance consultants promote and uphold the practice of good corporate governance. Like the ICD which is comprised of mainly of individual corporate directors and reputational agents committed to the professional practice of corporate directorship in the Philippines in line with global principles of modern corporate governance.

These CG consultants attend to the professional needs of corporate directors directly related to their serving on a Board of Directors and raise the standards for the professional practice of corporate directorship. They accredit corporate directors committed to enhancing the long-term value of the corporation they serve through the observance of corporate governance principles, ethics and social responsibility.

## 6. Recent Developments in Corporate Governance

### 6.1 Corporate Governance Developments

The main elements of recent revisions on the Corporate Governance Code (MC No. 6, Series of 2009), which took effect on 15 July 2009:

- Shifting of the responsibility of implementing the provisions of the revised Code from the Compliance Officer to the Board of Directors of the company;
- Expanding the Board's traditional policymaking role to include providing an independent check on management;
- Revision of the definition on the coverage of Corporate Governance specifically to shareholders;
- Inclusion of the provision for Alternative Dispute Resolution in amicable settlement of differences between corporation and stockholders, corporation and third parties, including regulatory authorities;
- Emphasis on the role of the Audit committee and internal control system;
- Implement policies and procedures to ensure integrity and transparency of related party transactions;
- Requirement for Compliance Officer to have at least the rank of VP, and in his absence the corporate secretary to act as such; and
- Inclusion of a provision relative to the regular review of the Code of Corporate Governance and the requirement of submitting a corporate governance scorecard.

### 6.2 Enforcement of Corporate Governance Rules

The Revised Code of Corporate Governance provides for administrative sanction (a fine of not more than P200,000 (US\$4,380<sup>86</sup>) for every year of violation.

### 6.3 Current Issues and Challenges for Corporate Governance

#### *Priorities for Reform*

- Encourage further broadening of the ownership of publicly listed companies in the Philippine corporate sector to reduce systemic risks involved in highly concentrated ownership;
- Introduce amendments to the Corporation Code to address gaps and concerns on transparency. Some proposed amendments are the following:
  - Require disclosures of underlying ownership of shares held by nominees and holding companies; and

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<sup>86</sup> Based on average exchange rate for the first five months of 2010, P45.6611:US\$1.

— Require disclosures of material changes in ownership

- Further the regime of corporate governance among publicly-listed companies by advocating the creation of minority shareholder groups.
- Include Independent Directors as additional respondents in future corporate governance scorecard surveys.

### **Financial Crisis**

In the banking sector, reforms that encourage the strengthening of capital positions and broaden avenues for risk management, including consolidated and risk-based supervision, the enhancement of corporate governance and disclosure standards and fostering transparency in reporting will continue to be implemented. These initiatives were instrumental in instilling order and depth in the banking system ahead of the onset of the global financial crisis.

## **Key Corporate Governance Rules and Practices in the Philippines**

Element	Yes	No	Source(s) of Rule	Comments
1. Do shareholders add items to the agenda for shareholders' meetings?	X		SL	
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X			
3. Must company transactions with its insiders be on a non-preferential basis?				
4. Is a super majority vote required for major company acts affecting shareholder rights?	X		CL	
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors? What percentage?	X		SL	At least two or 20% of the BoD
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?	X X		SL CGC	
7. Do independent directors decide what information the board receives from management?				
8. Are the chairman of the board and chief executive officer different persons in the majority of listed companies?	X		CGC	
9. Are all board members elected annually?	X		SL, CGC	
10. Does the board oversee enforcement of a company code of conduct?	X		CGC	
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with IFRS <sup>5</sup> ?	X		SL, CGC	
12. Are the identities of the five largest shareholders disclosed?	X		SL, CGC	
3. Is compensation of company executive officers disclosed?	X		SL, CGC	

Element	Yes	No	Source(s) of Rule	Comments
14. Are extraordinary corporate events disclosed?	X		SL, CGC	
15. Are risk factors disclosed in securities offering materials?	X		SL	
16. Are transactions of a company with its insiders disclosed?	X		SL, CGC	

*Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory*

## Sources

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# Russian Federation

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in the Russian Federation

#### 1.1 Background

##### *Historical overview*

Corporate governance and the regulation of corporate relations in Russia have a short history.

On 19 June 1990, the USSR Council of Ministers approved the regulations on joint-stock companies and limited liability companies, as well as Regulations on securities. Six months after the adoption of the said regulations the Council of Ministers of the Russian Soviet Federal Socialist Republic (RSFSR) adopted similar regulations that extended only to the territory of the RSFSR. In line with the general trend of denationalization of the economy, the further development of the legislation on joint-stock companies was managed through the adoption of laws and regulations governing the transformation of state enterprises into joint-stock companies.

By the end of 1990s, the basic laws of the Russian Federation were adopted, replacing the USSR legislation in the area of corporate governance (Law on the Joint-Stock Companies, Law on the Limited Liability Companies), securities market regulation (Law on Securities Market) and protection of investor rights. The stock market in the conventional sense of the term began to develop. The 2000s saw continued efforts to improve the institutions and the infrastructure of the stock market as well as corporate governance.

After the 1998 crisis, the stock market took until 2003 to fully recover. Mechanisms for collective investment (mutual funds) became fully operational and sustained growth in net asset value lasted until the global financial crisis of 2008. The role of the financial market in the economy increased markedly in the period 2006-07.

The strengthening role of financial markets was accompanied by increased trading volumes, rising liquidity, as well as greater recourse of Russian companies to the stock market as a source of long-term investment. The ratio of stock market capitalization to GDP had not exceeded 20% (1997-2004). But by 2007, stock market capitalization already amounted to 32.3 trillion rubles versus the GDP of almost 33 trillion rubles. By the end of 2009 the value of corporate bonds reached 2,387 billion rubles.

##### *Existing regulatory framework*

The system of legislative regulation of corporate relationships includes:

- the Civil Code of the Russian Federation,

- the Federal Law dated 26 December 1995 No. 208-FZ “On Joint-Stock Companies” (hereinafter—JSC Law),
- the Federal Law dated 8 February 1998 No. 14-FZ “On Limited Liability Companies),
- the Federal Law dated 22 April 1996 No. 39-FZ “On Securities Market”,
- the Federal Law dated 4 October 2002 “On Insolvency (Bankruptcy)”,
- the Federal Law dated 21 December 2001 No. 178-FZ “On Privatization of State and Municipal Property”,
- the Federal Law dated 14 November 2002 No. 161-FZ “On State and Municipal Unitary Enterprises”,
- federal laws on state corporations,
- Regulations on the register of holders of registered securities, approved by the Federal Securities Commission on 2 October 1997 No. 27,
- Regulations on information disclosure, approved by the order of the Federal Service for Financial Markets on 10 October 2006 No. 06-117/pz-n,
- Regulations on depository activities, approved by the order of the Federal Service for Financial Markets dated 16 October 1997 No. 36,
- Additional Requirements for procedure of preparing, convening and holding general shareholders’ meeting approved by the decision of the Federal Service for Financial Markets No. 17 dated 31 May 2002.

Federal Service for Financial Markets also approved the Code of Corporate Conduct on 4 April 2002 No. 421/r. Although not mandatory, most of its provisions are included in the listing requirements of Russia’s major bourses, RTS and MICEX. In Russia there are more than 10 industry codes of corporate conduct, (voluntary), the best known of which are the codes developed by the Association of Independent Directors and the Russian Institute of Directors.

## **1.2 Trends**

It should be noted that the number of listed companies is on the rise, more often involving debt securities rather than equity securities. As of 15 March 2010 on the RTS stock exchange (Russian Trading System) there were 85 joint-stock companies in the quotation lists, including five joint-stock companies in the A1 list, 17 companies in the A2 list, and 63 companies in the B list. The number of joint-stock companies according to the Uniform State Register of Legal Entities as of 1 February 2010 was 195,697. Thus, the proportion of companies whose shares are traded on the stock exchange constitutes 0.043% of the total number of joint -stock companies. The average median value of a controlling stake reaches 69% among companies in the RTSI. RTS equity market capitalization is US\$811 billion, including US\$683.0 billion of companies whose shares are included in the RTS Index, and US\$534.2 billion in the companies whose shares are included in the quotation lists.

## **1.3. Key Corporate Governance Rules and Practices**

For key corporate governance rules, see Key Corporate Governance Rules and Practices in the Russian Federation, p. 196.

# **2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules**

## **2.1 Development of Corporate Governance Rules**

The legislative body of the Russian Federation is the Federal Assembly of the Russian Federation, consisting of two chambers, the State Duma and Federation Council. The

government of the Russian Federation has the right of legislative initiative. Among the bodies of the Executive, subordinate to the government of the Russian Federation, the Ministry of Economic Development of the Russian Federation and the Federal Service for Financial Markets are responsible for setting the policy in the area of corporate governance and securities market. These bodies of the Executive have expert and advisory councils whose members are representatives of the academic community, business, public organizations and managerial associations. These councils organize the work to examine the draft regulations on corporate governance and securities market developed by the bodies of the Executive and other experts.

## **2.2 Enforcement of Corporate Governance Rules**

In accordance with the Russian law, a company can be subject to civil and administrative liability while an official of the company can also be subject to criminal responsibility. The main federal bodies of the Executive authorized to conduct administrative investigations in the area of corporate governance and securities market are the Federal Service for Financial Markets and the Federal Tax Service. Criminal cases with respect to the crimes that can be attributed to the field of corporate relations may be initiated by investigators of the Ministry of Internal Affairs. Claims of shareholders against the company are still fairly rare, due to the fact that prior to October 2009 the procedure for filing such suits was not legally regulated.

## **2.3 Assessment of Corporate Governance Practices**

Work on preparing a self-assessment report according to the OECD Corporate Governance Principles has just begun. There is a tentative understanding that the Russian law on joint-stock companies and trends of its change are consistent with these principles.

# **3. Awareness and Advocacy for Good Corporate Governance**

## **3.1 Company Directors**

In Russia there are several managerial associations. The Association of Independent Directors and the Russian Institute of Directors are among the biggest. The Association of Independent Directors has 515 members, all of whom are professional directors. Membership of the Russian Institute of Directors comprises Russian and international companies. In addition to Russia's managerial associations there are associations of lawyers specializing in corporate law. The largest of these are Corporate Lawyer Association and the Russian Association of Lawyers. All aforementioned associations hold round table discussions, seminars, conferences and classes designed to enhance the professional skills of managers and lawyers in the field of corporate governance law.

In the absence of mandatory requirements for directors (except for certain occupational areas subject to licensing), there is a high demand for the services provided by various organizations offering workshops to enhance skills in the field of corporate governance.

## **3.2 The Media**

Among the measures designed to develop Russia as an International Finance Center, the government of the Russian Federation has been considering the improvement of financial literacy among the general public, which would involve the dissemination of information through the media. This information would include issues of corporate governance and corporate finance.

There is a wide range of professional periodicals in printed and electronic form in the Russian Federation, some of which are wholly or partially dedicated to issues of corporate finance, corporate governance and law. Such publications include the following magazines: “Joint-Stock Bulletin”, “Joint-Stock Review”, “Business Online”, “Money”, “Director”, “Corporate Lawyer”, “Profile”, “RBC Daily”, “Mergers and Acquisitions”, “Finance” and “Economy and Law”.

### **3.3 Educational System**

The curriculum of economic faculties and departments of higher and secondary specialized educational institutions includes courses on general management and corporate finance. In the law faculties and departments of higher and secondary specialized institutions educational programs include courses on civil and administrative law, with lectures on civil law on legal entities and securities, legislation on the securities market, the administrative responsibility for offenses in the securities market.

### **3.4 The Stock Exchange**

MICEX Group (including “MICEX Stock Exchange”, “Moscow Interbank Currency Exchange”) provides various training courses and workshops for directors, including some in cooperation with the Association of Independent Directors.

## **4. Corporate Governance of State-Owned and Family-Controlled Enterprises**

### **4.1 State-Owned Enterprises**

The Federal Agency for Management of State Property (Rosimushchestvo) exercises the rights of shareholder on behalf of the Russian Federation in the state-owned enterprises.

The strategic functions of public policy making in individual sectors and of management of state property in the Russian Federation are split among various federal bodies of the Executive. Thus, the function of public policy making in individual sectors of the economy is carried out by sectoral ministries (Ministry of Economic Development, Ministry of Finance, Ministry of Health and Social Development, Ministry of Transport, Ministry of Industry and Trade, Ministry of Communications, and others). Public policy making in the management of federal property is the responsibility of the Ministry of Economic Development of the Russian Federation, while the immediate state property management is the function of Rosimushchestvo.

The functions of state property management are performed by *ad hoc* bodies, with the distinction based on both territorial (federal/regional level) and sectoral principle.

#### ***The territorial principle***

In accordance with the Article 8 of the Constitution of the Russian Federation there are private, state, municipal and other forms of property in the Russian Federation.

Under paragraph 1 of Article 214 of the Civil Code of the Russian Federation state property comprises the property of the Russian Federation (federal property) and property of the subjects (regions) of the Russian Federation.

As a general rule, according to paragraph one of the Resolution of the government of the Russian Federation No. 738, the Federal Agency for Management of State Property (Rosimushchestvo) exercises shareholder rights on behalf of the Russian Federation of public

companies whose shares are owned by the Russian Federation (hereinafter joint-stock companies).

The property of the subjects (regions) of the Russian Federation is run by the executive authorities of those subjects.

### ***Sectoral principle***

In the cases specified by law, Rosimuschestvo exercises the rights of shareholder in agreement with the relevant ministries and agencies. In addition, the law may provide for the delegation of authority of the owner (shareholder) directly to the sectoral ministry.

For example, paragraph 5.11 of the Regulations “On the Ministry of Communications and Mass Media of the Russian Federation”, approved by government of the Russian Federation on 2 June 2008 No. 418 entrusts the Ministry of Communications and Mass Media (Minkomsvyaz of Russia) to exercise the authority of owner in respect of federal property transferred to federal state unitary enterprises and the federal public institutions subordinated to this Ministry.

Under paragraph seven of the Order of the Rosimuschestvo dated 11 October 2007, No. 3254-r “On Joint-Stock Company Russian Investment Fund for Information and Communication Technologies” Minkomsvyaz of Russia on behalf of the Russian Federation exercises the rights of shareholder of the Public Joint-stock Company “Rosinfocominvest” in accordance with the Decree of the government of the Russian Federation dated 9 August 2006, No. 476 “On Establishment of a Public Joint-stock Company Russian Investment Fund for Information and Communication Technologies”.

With regard to the specific requirements for corporate governance it should be noted that the requirements for corporate governance in these companies do not differ from those applicable to private companies.

The structure of corporate governance in the state-owned enterprises usually does not differ from the structure of corporate governance in private companies. However, there are some distinctive features related to the fact that “representatives of the state” are appointed simultaneously by several sectoral ministries.

At the same time it is worth noting that the state is currently moving away from direct involvement (through directives issued to public servants in the governing bodies) in the management of the state-owned enterprises. Hence, nowadays following international trends the state is moving towards the practice of election of independent directors and professional attorneys to the management bodies of the state-owned enterprises.

Professional Attorney is a representative of the Russian Federation who is not a public servant and who acts on the basis of directives similar to the directives issued to government officials representing the Russian Federation in general meeting of shareholders and board of directors of joint-stock companies.

The difference between independent director and Professional Attorney is that an independent director shall vote on the meeting agenda guided by his/her own judgments, while the Professional Attorney shall request directives from Rosimushchestvo on certain issues. The list of issues on which the professional attorney requests directive from Rosimushchestvo is set in paragraph 17 of the Resolution of the government of the Russian Federation No. 738. Based on paragraph 17 of the Resolution No. 738, the body responsible for management of state property

is obliged to issue directives on issues referred to in sub-paragraphs 1, 3, 5, 6, 7, 9, 11 and 15 of paragraph one of Article 65 of the JSC Law:

- adoption of the agenda of the general meeting of shareholders;
- increase in the authorized capital by placing additional shares within the number and categories (types) of declared shares if it falls within the competence of the company as referred to in the company's charter in accordance with this Federal Law;
- establishment of an executive body of the company and early termination of its powers, if it falls within the competence of the company as referred to in the company's charter;
- recommendations on the size of dividend on shares and the procedure of its payment.

Compared with the previous (pre-2008) edition of Resolution No. 738, the list of the "directive-based" issues has been substantially reduced, and now mainly involves issues directly related to the risk of losing corporate control.

In order to improve the efficiency and effectiveness of joint-stock companies it was considered appropriate to set up three specialized committees within companies' boards of directors whose shares are owned by the Russian Federation:

- A committee on strategic planning;
- An audit committee;
- A committee on personnel and remuneration.

It was proposed that the chairpersons of the committees be elected from among those members of the company's board of directors who are not civil servants (independent directors and professional attorneys).

The following are examples of such functioning committees: Public Joint-stock Companies Transneft, RZhD, SG-Trans, Modern commercial fleet (Sovkomflot), Sheremetyevo International airport, Agency for Home Mortgage Lending.

## **4.2 Family-Controlled Enterprises**

Private companies in the Russian Federation have traditionally existed in the form of limited liability companies or private joint-stock companies. Requirements for corporate governance among the private companies are stricter than in the case of limited liability companies. However, the requirements for corporate governance in private and public companies do not differ in general. The Ministry of Economic Development of the Russian Federation is currently drafting amendments to laws to provide differential regulation of corporate relationships in the private and public companies (more permissive regulation for the former and higher standards of corporate governance for the latter).

Companies that are preparing to list are obliged to take measures to ensure that their corporate governance complies with the listing requirements. In this regard, private companies will upgrade their corporate governance when planning to list.

## **5. The Role of Professional Service Providers in Corporate Governance**

As a rule, experts in securities publicize in their reports and inform the companies that they ensure the compliance of the company's performance to the highest standards of corporate governance.

Auditors' reports on public companies, state-owned unitary enterprises, the majority of state corporations are subject to mandatory publication.

## 6. Recent Developments in Corporate Governance

### 6.1 Corporate Governance Developments

To date, in accordance with the concept of corporate law development approved in 2006 by the government of the Russian Federation and the anti-crisis action plan of the government of the Russian Federation amendments were introduced to:

- The Civil Code of the Russian Federation and the legislation on limited liability companies (Federal Law dated 30 December 2009 No. 312-FZ),
- Bankruptcy legislation (Federal Law dated 28 April 2009 No. 73-FZ),
- Legislation on joint-stock companies and the securities market (Federal Laws dated 3 June 2009 No. 115-FZ, 27 December 2009 No. 352-FZ),
- Arbitration legislation and legislation on legal entities (Federal Law dated 19 July 2009 No. 205-FZ).

#### **A) “Anti-raider Act” (Federal Law dated 19 July 2009 No. 205-FZ)**

The rationale behind the adoption of this law was to ensure consistency among judicial decisions on corporate disputes, is addressed by the following measures:

- Introducing the notion of “corporate dispute” and a clear distinction between judicial jurisdiction by referring such disputes to the jurisdiction of arbitration courts;
- Exclusive jurisdiction of the cases of corporate disputes based on the location of the entity in respect of which the dispute emerged;
- Introducing the mechanisms for the consolidation of inter-related claims of corporate disputes;
- Specification of rules for the adoption of enforcing measures by the court, ensuring the efficiency of their adoption on the one hand, and precluding the possibility of “paralyzing” the business activity of the legal entity on the other;
- Introducing indirect actions, ensuring shareholders' opportunities to file claims for damages to the company's directors;
- Introducing the concept of class action which is new to the Russian legislation, allowing new plaintiffs to “engage” in an existing legal proceeding.

The law increases the transparency of the legal proceedings.

#### **B) Law No. 312-FZ (amendments to the legislation on limited liability companies)**

One of the main reasons of amending the law on limited liability companies was to better protect the owners' rights.

According to the amended law:

- Information about the transition of shares is only reflected in the Unified State Register of legal entities;

- Transactions to transfer shares are subject to notarization, while the liability of notaries and requirements for its compulsory insurance became stricter;
- The Concept of agreements between shareholders was introduced; and
- Shareholders were given the right to sue for the return of stolen shares in the company.

**C) Federal Law dated 3 June 2009 No. 115-FZ “On Amending the Federal Law “On Joint-stock Companies” and article 30 of the Federal Law “On Securities Market”**

This law introduced the concept of shareholders’ agreement into the legislation on joint-stock companies. Thus the law solves the problem of providing greater freedom to shareholders in the formation of convenient models of corporate governance while preserving the basic mechanisms for the protection of property rights of minority shareholders, creditors and the public interest.

**D) Protection of the rights of creditors in bankruptcy**

Until recently, the bankruptcy legislation did not provide effective ways to return the assets that were deliberately alienated by the debtor to the detriment of creditors. In order to ensure uniform approaches to address the issues of challenging the transactions on grounds provided by the Law on Bankruptcy, the Plenum of the Supreme Arbitration Court of the Russian Federation issued a ruling on 30 April 2009 No. 32. Amendments to the general Law on Bankruptcy and the Law on Bankruptcy of Credit Institutions came into effect in early June 2009 (Federal Law dated 28 April 2009 No. 78-FZ).

Amendments to the bankruptcy legislation provide for:

- Simplification of procedures for cancellation of a transaction in bankruptcy that was intended to harm the property rights of creditors (suspicious transactions) and preferential transaction (with preference satisfaction). This sets the conditions under which a transaction can be recognized as invalid. Then it is possible to challenge a suspicious transaction on the basis of both objective criterion which is the disparity of counter-performance and subjective criterion which is the intention to cause harm to the debtor’s creditors in their ability to obtain satisfaction of their claims at the expense of the debtor’s property;
- Simplification of the proof of claims to call to account directors and “shadow directors” of the debtor recognized as a bankrupt;
- Lowering the cost of administering the bankruptcy procedures by considering the claims aimed at increasing the competitive estate within a single case (cancellation of suspicious transactions and prosecution of directors and “shadow directors”).

**6.2 Enforcement of Corporate Governance Rules**

In 2010 the Constitutional Court of the Russian Federation put an end to decades of dispute about who should be responsible for the unlawful cancellation of shares if the register of securities is the registrar. The history of court rulings on this issue was controversial: in some cases the registrar and the issuer were brought to justice, in others the issuer was so and a registrar additionally or registrar exclusively. In 2009 the law was amended. Article 44 of the JSC Law then provided for the right of the shareholder to sue for violations of his rights on the shares for the damages to the issuer and the registrar of society. These persons are jointly and severally liable. In addition, such a requirement by law may be charged with the directors of a joint-stock company under the second para of paragraph 2 of Article 71 of the JSC Law in case of violation of shareholder rights granted by the Chapter 11.1 of the JSC Law (which governs

the procedure for a mandatory offer by the person acquiring corporate control, and the procedure for redemption of shares by an owner of 95% of shares of authorized capital of a joint-stock company). The Constitutional Court of the Russian Federation upheld the compliance of this rule with the Constitution of the Russian Federation In January 2010 by ruling No. 2-P. In particular, Gazprom, Sberbank, Orenburgneft and Gazpromneft joint-stock companies filed a complaint, which noted that the claim for damages must be charged not with the issuer and the registrar, but with the direct tortfeasor, for example, the thief who stole the shares. The Constitutional Court of the Russian Federation stressed in its resolution that the work to keep the register of shareholders is directly related to the emission of shares, so the issuer must maintain proper records of shareholders' rights and be liable in case of violation of the rights of shareholders as a result of unreliable data. In the case of transfer of responsibility for keeping share records to the registrar, the issuer is not exempt from the said liability to the shareholder.

In April 2010, the Supreme Arbitration Court of the Russian Federation applied the doctrine of "disclosure of corporate cover" in the Edimax Ltd against Sh.Chigirinsky, who was recognized as the controlling shareholder of the company being the debtor in default on a loan agreement. Due to the fact that a causal relationship was found between the default on the obligations of the company and the instructions of its beneficiaries, Sh.Chigirinsky was brought to vicarious liability for the debts of the company. At the same time in May 2010, Russian Constitutional Court dismissed the complaint of a Cypriot company Lankrennan Investments Ltd on misinterpretation due to the judicial practice of certain legal provisions preventing prosecution of the controlling shareholders (in particular, with respect to the cases of liability for damages of "Eurocement" caused by its subsidiary joint-stock company "Ulyanovsktsement").

By early 2010, a uniform judicial practice had emerged with respect to the invalidation of transactions with conflict of interests committed in violation of the order of their approval (ruling of the Supreme Arbitration Court of the Russian Federation No. 40), the application of provisions on acquisitions and the oustings (a number of rulings of the Supreme Arbitration Court of the Russian Federation, the Constitutional Court of the Russian Federation), the implementation of the shareholders' preferential rights in the private companies and a number of issues of the law on bankruptcy, etc.

## **6.3 Current Issues and Challenges for Corporate Governance**

### **6.3.1 Challenges**

Currently there are corporate governance issues in the Russian companies, both typical to the issues affecting companies in other economies and ones specific to companies operating in the Russian Federation.

CG difficulties are caused, on the one hand, by the current stage of evolution of the Russian market (excessive concentration of equity in the hands of a few owners, little separation of ownership from management); and on the other hand, some issues are caused by deficiencies of legal regulation such as corporate governance in joint-stock companies being focused on public companies with dispersed share capital (this is rare in Russia, where the greatest number of shares in free float is 49%, and the average size of a controlling stake is equal to 69%).

In this regard, the main task facing the regulator is the alignment of corporate law with the current economic situation. In particular, the number of constraints associated with the use of redistribution mechanisms of corporate control (joint-stock agreement, multi-vote shares, etc.) by non-public companies' shareholders is expected to be reduced.

Investors in Russian companies also face the same problems that exist in foreign corporations including the high costs of participation in running the company, opportunistic behavior of directors and “shadow directors” and disclosure of information about the real owners of the company. Thus in order to enhance the protection of minority shareholders it is proposed to clarify the grounds for bringing controlling shareholders and directors to account, to change the regulation of the securities record-keeping system and to increase disclosure requirements for the beneficial owners of public companies. To reduce the cost of shareholders to exercise their rights it is proposed to extend the application of new communication technologies.

Regulators also confront the goal of improving the protection of the rights of other beneficiaries—the state, creditors and society. Debate is active on the introduction of requirements for the disclosure of non-financial (social) reporting of public companies. In order to protect the rights of creditors the legislation on bankruptcy and liquidation of companies has been significantly adjusted in recent years. At the same time, to ensure a balance between state and corporate interests a package of laws on financial improvement is now under consideration.

### **6.3.2 Priorities for Reform**

The priorities for reform of the corporate law are as follows.

1. In the area of start-up and establishment of companies:
  - simplify start-up procedures through the use of modern communication technologies and reduce time required for start-up;
  - establish model charters for the registration of small companies; and
  - increase the reliability of information contained in the Uniform State Register of legal entities.
2. In the area of reduction of shareholders’ costs of participation in the management of a legal entity:
  - increase the use of modern communication technologies for notifications to the shareholders, absentee voting and other corporate procedures;
  - reduce restrictions for non-public companies’ use of redistribution mechanisms of corporate control.
3. In the area of protection of the rights of shareholders and investors:
  - improve the grounds and the order for calling directors and controlling persons to account;
  - work out detailed rules on disclosure of information by public companies;
  - work out detailed rules on disclosure of information by officials of public companies;
  - improved regulation of the dividend policy of companies;
  - create a specialized financial court to resolve disputes between investors; and
  - improve the rules of approval of extraordinary transactions (large deals and transactions with conflict of interest).
4. In the area of protection of creditor rights:
  - improve the legislation on the procedure for recovery of the mortgaged property;
  - improve the rules of bankruptcy of groups and cross-border insolvency.
5. In the area of protection of public interests:

- raise the efficiency of reorganization bankruptcy proceedings;
- regulate responsibilities for disclosure of information about the socially useful activities of public companies (non-financial reports).

### **6.3.3 Financial Crisis**

During financial crisis the government of the Russian Federation developed an Action Plan aimed at improving the situation in the financial sector and selected industries. The Action Plan pursued the improvement of corporate law and bankruptcy law. Legislative initiatives were aimed at protecting property rights and the interests of creditors.

Pursuant to the Plan, the following federal laws, among others, have been developed and adopted:

#### **Federal Law dated 28 April 2009 No. 73-FZ**

**Federal Law dated 30 December 2008 No. 315-FZ** “On Amending the Federal Law”, “On Banks and Banking Activities” and some “other legislative acts of the Russian Federation” (in terms of improving the procedures for the reorganization of credit institutions and non-banking sector organizations).

The Law is aimed at creating conditions for business consolidation and cross-sectoral mobility of capital.

This is achieved through mechanisms that facilitate the reorganization procedure for credit institutions, as well as public companies in the forms of merger, affiliation and transformation by removing the absolute right of creditors for early repayment in case of reorganization and ensuring a balance of interests between the reorganized company and its creditors.

Simultaneously, the law specifies the rules regarding disclosure of information about the reorganization of legal entities (including credit institutions).

The Law facilitates the processes of reorganization of Russian companies, including banks, ensures conditions for accelerating inter-sectoral mobility of capital, optimizes the procedure of reorganization in the form of mergers and acquisitions. In a financial crisis environment this will allow Russian companies to quickly reconfigure their businesses and adapt to new external conditions.

**Federal law dated 18 July 2009 No. 182-FZ** “On Amending the Federal Law”, “On Non-state Pension Funds” and the Federal Law “On Investments to Finance the Funded Part of Labor Pensions in the Russian Federation”.

The Law is aimed at providing broader opportunities for investing pension savings of the insured persons who are not utilizing the right to choose the investment portfolio (management company) or non-state pension fund.

Implementation of this Federal Law will ensure more effective use of long-term investment resources generated within the system of investment of pension savings, through their deployment in the real economy. In addition, a higher profitability of investment will be ensured in the long run which will enhance the protection of the insured persons’ rights.

Besides, amendments were introduced to the corporate law to simplify the procedure of exchange of debt for capital stock and the issuance of bonds (**Federal Law dated 29 December 2009 No. 352-FZ**).

At the same time, the State ensured an increase in the liquidity of the stock market, restored solvency of credit institutions, as well as provided lending to the real sector of the economy through the issuance of subordinated loans through authorized banks.

## Key Corporate Governance Rules and Practices in the Russian Federation

Element	Yes	No	Source(s) of Rule <sup>a</sup>	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for shareholders' meetings?	X		Federal Law "On Joint-Stock Companies" (Article 53)	Shareholder(s) who jointly hold not less than 2% of the voting shares is (are) entitled to raise issues in the agenda of the annual general meeting of shareholders.
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		Code of Corporate Conduct (Para 1, Section 2.1.2 of Chapter 2, Section 2.1 of Chapter 2)	<p>Recommends that a society:</p> <ul style="list-style-type: none"> <li>• Ensures the presence of the director general (CEO), members of the governing board, and members of the board of directors at the general meeting so that shareholders have the opportunity to ask them questions. Accountability of the members of the board of directors, director general (CEO), members of the governing board to the shareholders of the society implies the right of shareholders to request written reports and answers to questions relating to various aspects of society activities;</li> <li>• Establishes a procedure for conducting the general meeting of the society ensuring a reasonable equal opportunity to all persons present at the meeting to express their views and ask questions.</li> </ul>
3. Must company transactions with its insiders be on a non-preferential basis?	X		Federal Law "On Joint-Stock Companies" (Article 83)	Provides a special procedure for approval of transactions in which there is an interest—such transactions are approved either by independent directors or shareholders who are not interested in the transaction.
4. Is a super majority vote required for major company acts affecting shareholder rights?			Federal Law "On Joint-Stock Companies" (section 4 of Article 49, Article 79)	<p>General meeting of shareholders (3/4 votes):</p> <ul style="list-style-type: none"> <li>• Changes and amendments to the company's charter or approval of the new edition of the charter;</li> <li>• Reorganization of the society;</li> <li>• Liquidation of the society, the appointment of the liquidation committee and approval of interim and final liquidation balance sheets;</li> <li>• Identification of the number, nominal value, category (type) of declared shares and rights granted by these shares;</li> <li>• Acquisition by the society of shares in cases stipulated by this Federal Law;</li> <li>• Approval of a big deal (if the transaction involved property of a value more than 50% of the book value of assets).</li> </ul>
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors? What percentage?	X		Federal Law "On Joint-Stock Companies" (Section 3 of Article 83) Code of Corporate Conduct (Section 2.2 of Chapter 3)	In a society where the number of shareholders owners of the voting shares exceeds 1,000, the decision to approve a transaction, in which there is an interest, is taken by the board of directors (supervisory board) and by a majority of independent directors' votes who are not interested in the

Element	Yes	No	Source(s) of Rule <sup>a</sup>	Comments
			Guidelines for the organizers of trading on the securities market to monitor joint-stock companies' adherence to the Code of Corporate Conduct (order of the Federal Securities Commission, FCSM)  Resolution of the government of the Russian Federation No. 738 on the management of federally owned shares of public companies (Section 16)	transaction.  • Recommends that independent directors be elected on the board of directors.  • Establishes that the board of directors of a company whose securities are included in the quotation lists "A" of first level must include at least three independent directors who meet the requirements of the Code.  • Encourages the increasing use and development of the institution of independent directors in companies with state participation.
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?		X	Federal Law "On Joint-Stock Companies" (Article 12)	The fees to the company's auditor are determined by the board of directors, and the payment of remuneration to members of the audit commission is set by the decision of the general meeting of shareholders.
7. Do independent directors decide what information the board receives from management?		X		If independent directors are endowed with these powers by the company's charter.
8. Are the chairman of the board and chief executive officer different persons in the majority of listed companies?	X		Federal Law "On Joint-Stock Companies" (Article 66)	The person performing the functions of the sole executive body (chief executive) cannot simultaneously be chair of the board of directors.
9. Are all board members elected annually?	X		Federal Law "On Joint-Stock Companies" (Article 66)	Members of the board of directors are elected by the general meeting of shareholders for a term until the next annual general meeting of shareholders.
10. Does the board oversee enforcement of a company code of conduct?	X		Guidelines for the organizers of trading on the securities market to monitor joint-stock companies' adherence to the Code of Corporate Conduct (order of the Federal Securities Commission, FCSM)	Joint-stock companies disclose the information on their adherence to the Code of Corporate Conduct to the organizers of trading at least once a month, and as result of significant events in the company.
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with (International Financial Reporting Standards) IFRS?				
12. Are the identities of the five largest shareholders disclosed?	X		Federal Law "On Securities Market" (Article 30)	In the case of registration of the securities prospectus issuer is obliged to disclose information about such basic facts as the inclusion in the register of shareholders of the issuer of the shareholder who owns at least 5% of ordinary shares of the issuer, as well as any change that resulted in the share belonging to the shareholders of such shares becoming more or less than 5%, 10%, 15%, 20%, 25%, 30%, 50% or 75% of placed ordinary shares.
13. Is compensation of company executive officers disclosed?	X		Federal Law "On Securities Market" (Article 30)  Regulations on information disclosure by issuers of securities (order of the Federal Service for Financial Markets dated 10 October 2006)	In the case of registration of the securities prospectus issuer is obliged to disclose information. On each of the bodies of the issuer (other than a natural person performing the role of the sole executive body of the issuer) the following data are described:  • All types of compensation with the indication of the size, including salary, bonuses, commissions,

Element	Yes	No	Source(s) of Rule <sup>a</sup>	Comments
			No. 06-117/pz-n) (Section 5.3 of Annex 10)	benefits and/or reimbursement of expenses; <ul style="list-style-type: none"> <li>• Other property transactions, which were paid by the issuer for the last completed fiscal year;</li> <li>• Information on the existing agreements concerning such payments in the current fiscal year.</li> </ul>
14. Are extraordinary corporate events disclosed?	X		Federal Law “On Securities Market” (Article 30)	In the case of registration of the securities prospectus issuer is obliged to disclose information in the form of reports of substantial facts (events, actions) relating to financial and business activities of the issuer.
15. Are risk factors disclosed in securities offering materials?	X		Federal Law “On Securities Market” (Article 22)	Prospect of securities must contain basic information about the financial and economic status of the issuer and the risk factors, including the risks arising from the acquisition of the securities which are currently being placed.
16. Are transactions of a company with its insiders disclosed?	X		Federal Law “On Joint-Stock Companies” (Article 82) Regulations on information disclosure by issuers of securities (order of the Federal Service for Financial Markets dated 10 October 2006 No. 06-117/pz-n) (Section 8.2)	The persons concerned are obliged to inform the board of directors, the audit commission (auditor) of the company on committed or anticipated transactions which became known to them and in which they can be recognized as interested persons. Joint-stock companies are required to disclose information in the form of annual report, including the list of current financial year’s transactions recognized in accordance with the Federal Law on Joint-Stock Companies as transactions where interest existed in concluding those. For each transaction it’s necessary to indicate the interested person(s), essential conditions and governing body of the company which adopted the decision on approval of the transaction.

Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory

# Singapore

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in Singapore

#### 1.1 Background

All companies which are incorporated in Singapore have to comply with the Companies Act, which is administered by the Accounting and Corporate Regulatory Authority (ACRA). Companies seeking to list on Singapore Exchange Limited (SGX), whether local or foreign, must meet the minimum admission standards, and are carefully evaluated by SGX before they are admitted. Once listed, they are required to comply with SGX's continuing listing obligations. Their governance framework and practices are guided by both the SGX's Listing Rules and the Singapore Code of Corporate Governance (Code).

The Companies Act is undergoing a review that was initiated in October 2007. The Listing Rules are currently in the process of being amended while the Code, which was issued in July 2005, is under review.

More details on Singapore's key corporate governance rules and practices can be found in Key Corporate Governance Rules and Practices in Singapore, p. 204.

#### 1.2 Trends

The number of publicly traded companies has increased over the last five years. Market capitalization was similarly on an uptrend until 2007, before the market was adversely affected by the financial crisis. More details can be found below.

Year	No. of Listed Companies	Range of Market Capitalisation
2005	681	S\$2.7 million—S\$43.6 billion
2006	725	S\$3.5 million—S\$52.1 billion
2007	773	S\$5.5 million—S\$63.7 billion
2008	774	S\$1.1 million—S\$40.6 billion
2009	775	S\$2.1 million—S\$49.5 million

*Note: Figures as at 31 December 2009. De-listed companies are excluded from the number of listed companies.*

## **2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules**

### **2.1 Development and Enforcement of Corporate Governance Rules**

The Monetary Authority of Singapore (MAS) and the SGX took over the oversight of corporate governance of listed companies with effect from September 2007. This move was to clarify and streamline responsibilities for corporate governance matters for listed companies.

MAS is responsible for market conduct regulation in the financial sector with regard to development of rules and regulations, enforcement, market supervising and licensing. Under the Securities and Futures Act (SFA) and Financial Advisers Act (FAA), MAS has a mandate to perform its market conduct regulatory responsibilities. In addition to MAS's regulation, for entities listed on the SGX, SGX performs self-regulatory functions by developing rule books for entities listed on the securities and derivatives markets, conducting market surveillance, investigating alleged misconduct by its members and enforcing compliance with its Listing Rules.

The Code is under the purview of MAS and SGX. While compliance with the Code is not mandatory, companies listed on SGX are required under the Listing Rules to disclose their corporate governance practices and to give explanations for deviations from the Code in their annual reports.

Where relevant, SGX has incorporated some of the recommended practices in the Code into the Listing Rules for compliance by listed companies. SGX will take the necessary disciplinary action (private or public reprimand) against listed companies for breaches of the Listing Rules.

In 2009, SGX undertook 29 disciplinary actions against listed companies for failure to comply with disclosure requirements, of which, three were public reprimands. In 2008, five private reprimands were issued.

## **3. Awareness and Advocacy for Good Corporate Governance**

### **3.1 Company Directors**

The Singapore Institute of Directors (SID) seeks to promote the professional development of directors and corporate leaders and encourage the highest standards of corporate governance and ethical conduct.

SID currently has about 1,500 members. Further details on the membership of SID can be found on the Internet: ([http://www.sid.org.sg/main/membership\\_breakdown](http://www.sid.org.sg/main/membership_breakdown))

Training for directors is not mandatory under Singapore's legislation. Directors are encouraged to receive further relevant training, particularly on relevant new laws, regulations and changing commercial risks, from time to time. SID organises and conducts professional training courses and seminars to meet the needs of its members and company directors generally.

### **3.2 Media**

Local academic institutions work with journalists to cover corporate governance issues responsibly. For instance, the leading business newspaper in Singapore, The Business Times,

introduced the Business Times Corporate Transparency Index (CTI) in conjunction with the NUS Corporate & Financial Reporting Centre to gauge the transparency of Singapore-listed companies. In addition, the financial press regularly reports on corporate governance issues and developments. For instance, The Business Times organizes the Singapore Corporate Awards annually to recognize excellence in shareholder communication and corporate governance.

### **3.3 Educational System**

Students interested in corporate governance have the option of taking related modules in tertiary institutions. MBA programs do allow students to take courses in corporate governance. For instance, the Nanyang Business School has a division in business law that offers modules in company law and corporate governance.

Judges and judicial officers are required to learn the basics of company law before they can practice. More advanced corporate governance modules can be taken at tertiary institutions at the officer's discretion.

### **3.4 Stock Exchange**

SGX supports SID in its efforts to enhance director training and professional development in corporate governance practices, in particular, through the following two programs:

- SGX-SID Listed Company Director Program—Provide comprehensive training of company directors on corporate governance.
- SGX-SID Growing Enterprise Management Program—Provide practical framework and principles-based guidance on evaluating and improving governance in growing enterprises.

SGX promotes investor education and financial literacy among the general public through regular seminars and events. SGX has also issued two reference guides to equip retail investors with the skills to obtain important information in annual reports and to ask pertinent questions during AGMs. Further, SGX engages its shareholders through annual Investor Relations open days.

## **4. Corporate Governance of State-Owned and Family-Controlled Enterprises**

### **4.1 State-Owned Enterprises**

The Government of Singapore Investment Corporation (GIC) and Temasek Holdings are the government's key investment companies. GIC is an investment management company whose objective is to achieve a long-term real rate of return on assets belonging to the Singapore government by investing internationally. Temasek is an investment holding company which owns and invests a diversified portfolio of assets in Singapore and overseas with the objective of delivering long-term returns to its shareholder, the Singapore government. Government-linked companies are subjected to the same requirements as those in the companies and securities laws and there are no important corporate governance issues with them. In fact, government-linked companies in Singapore have been recognized as good examples of corporate governance. For instance, SingTel and SMRT Corporation have received the Singapore Corporate Awards, which recognize excellence in shareholder communication and corporate governance.

## 4.2 Family-Controlled Enterprises

Listed family-controlled enterprises are subjected to the same requirements and corporate governance standards as any other listed company.

## 5. Role of Professional Service Providers in Corporate Governance

There are currently no specific requirements under the Listing Rules for accounting and auditing firms or corporate governance consultants to provide comments, whether to the public or to the companies they serve, in respect of the companies' compliance with the principles of good corporate governance.

## 6. Recent Developments in Corporate Governance

### 6.1 Corporate Governance Developments

MAS and SGX took over the oversight of corporate governance of listed companies with effect from September 2007. The initiatives following the transfer of the oversight of corporate governance of listed companies focused on improving the practical implementation of the Principles of the Code. In January 2008, MAS, ACRA and SGX established the Audit Committee Guidance Committee (ACGC) to develop practical guidance for audit committee members of SGX-listed companies to enhance their effectiveness. The ACGC completed its work in October 2008 with the submission of its *Guidebook for Audit Committees in Singapore*. MAS and SGX also initiated a strategic review of SID to recommend improvements to the structure and activities of the institute to better meet the changing needs of directors and the corporate community in Singapore.

In February 2010, MAS established the Corporate Governance Council to promote a high standard of corporate governance in companies listed in Singapore, so as to maintain investors' confidence and enhance Singapore's reputation as a leading and trusted international financial centre. Members of the Council are drawn from the business community and stakeholder groups. Representatives from MAS, ACRA and SGX have also been appointed to the Council. The Council is in the process of reviewing the Code.

In March 2010, MAS issued a consultation paper that sets out proposed enhancements to the MAS Corporate Governance (CG) Framework which is applicable to locally-incorporated banks, financial holding companies and direct insurers. More details on the consultation paper can be found in 6.3.2.

### 6.2 Enforcement of Corporate Governance Rules

The disclosure rules of securities exchanges in Singapore are given statutory backing, in that the SFA prohibits a listed company from intentionally, recklessly or negligently failing to notify the exchange of information required by the exchange's listing rules to be disclosed to the exchange, for the purpose of making the information available to the market. A company that breaches this statutory provision commits a criminal offence and may also be subject to civil penalty suits by MAS. For example, in April 2006, a company listed on SGX paid a civil penalty settlement sum to MAS for failing to properly disclose to SGX its expected growth in sales and earnings.

Furthermore, directors of listed companies may also be prosecuted for wrongdoing concerning timely and accurate disclosures of material information. For instance, an independent director and non-executive chairman of a company listed on SGX, who also chaired its audit committee,

was fined and disqualified from acting as a company director for a year after he was convicted in August 2009 of failing in his director's duties. The director had approved the release of a misleading announcement to SGX without seeing or knowing what the announcement was about. On his appeal against his sentence in May 2010, the period of disqualification was doubled to two years by the High Court, which issued a stern message reaffirming the exemplary standards of corporate governance expected in Singapore. Two other independent directors and the former chief operating officer of the company are facing criminal charges for failing to disclose material information and disclosing inaccurate information to SGX.

SGX itself has undertaken the following recent enforcement actions:

- In May 2010, SGX issued a public reprimand against a listed company and its directors for breaching Listing Rule 703 by failing to disclose material information on a timely basis and Listing Rule 704(12) by failing to comply with SGX's directive to release the executive summary of the Special Auditors' report to the public. SGX had previously directed the company to appoint Special Auditors to investigate into the affairs of the company. Further, SGX-listed companies are required to consult SGX before they appoint any of the company's directors as a director or member of management.
- In April 2010, SGX published a list of 10 ex-directors whom SGX had found to not demonstrate the qualities expected of directors and management of SGX-listed companies pursuant to Listing Rules 210(5)(b) and 720. SGX also advised its listed companies to consult SGX before they appoint any of the persons as a director or member of their management.
- In March 2010, SGX issued a public reprimand against a listed company for breaching Listing Rule 703 by making false and misleading statements in its announcement on the reasons for the resignations of five directors.

## **6.3 Current Issues and Challenges for Corporate Governance**

### **6.3.1 Challenges**

The challenges faced in efforts to promote compliance with better standards and practices of good corporate governance are as follows:

- Enhancing the pool of quality independent directors
- Promoting active participation by shareholders during AGMs
- Ensuring the compliance by companies with the Code in substance rather than in form

The recent financial crisis also highlighted the importance of effective risk management oversight at the Board level. In the recently issued MAS consultation paper that sets out proposed enhancements to the MAS Corporate Governance Framework, the key corporate governance issues that have been identified are:

- The need for directors to be equipped with the appropriate skills to oversee the operations of companies
- The time commitment expected of each director to ensure that directors are able to devote the time needed to perform their oversight roles
- Issues related to the independence of directors
- Role of the boards in relation to remuneration
- Role of boards in relation to the management of risks for companies

### **6.3.2 Priorities for Reform**

Both the Companies Act and the Code are currently under review.

In December 2009, SGX issued a public consultation on proposed Listing Rule amendments to strengthen corporate governance practices among listed companies. Some of the key proposals include:

- Empowering SGX with the right to approve appointments of directors, CEOs and CFOs under specific circumstances, such as where the issuer is the subject of an investigation
- Requiring disclosure, under certain circumstances, of share pledging arrangements entered into by major shareholders where enforcement over these arrangements may have an impact on the issuer
- Requiring shares of controlling shareholders and their associates to be held in custody with The Central Depository Pte Ltd or a suitable depository agent to give SGX greater visibility over the interests of controlling shareholders
- Audit Committee to have the discretion to commission specific independent audit on internal controls
- Audit Committee to disclose its opinion on the adequacy of internal controls and risk management policies and systems in the annual report
- Requiring at least one independent director in office at all times to ensure continuity of an independent element on the board

MAS has also recently issued a consultation paper that sets out proposed enhancements to the MAS Corporate Governance Framework which applies to locally-incorporated banks, financial holding companies and direct insurers. The proposals emphasize the importance of the role of the Board and the need for directors to be equipped with the appropriate skills and have the commitment to oversee the operations of the financial institutions.

The consultation paper can be accessed here:  
[http://www.mas.gov.sg/resource/publications/consult\\_papers/2010/Consultation Paper on C G Regs and Guidelines.pdf](http://www.mas.gov.sg/resource/publications/consult_papers/2010/Consultation_Paper_on_C_G_Regs_and_Guidelines.pdf)

## Key Corporate Governance Rules and Practices in Singapore

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for shareholders' meetings?	X		CL	Shareholders can decide on agenda of a meeting in three instances: a) Under section 176, Companies Act - where it is requisitioned by members holding 10% voting rights b) Under section 177, Companies Act where two or more member holding 10% or more of total number shares issued or 5% in numbers for companies with no share capital call a meeting c) Under section 183, Companies Act where members (a) representing not less than 5% of the total voting rights; or (b) who represent not less than 100 members holding shares which have been paid up to an average of S\$500 per member requisition the circulation of members' resolutions. However, under normal circumstances, the agenda for shareholders' meeting is set by the company.
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		CL, CGC	Under section 180 Companies Act, shareholders can speak and vote at general meetings. Principle 15 of the Code states that companies should encourage greater shareholder participation at AGMs, and allow shareholders the opportunity to communicate their views on various matters affecting the company.
3. Must company transactions with its insiders be on a non-preferential basis?	X		SLR	The transaction must be on normal commercial terms and not prejudicial to the interests of the company and its minority shareholders.
4. Is a super majority vote required for major company acts affecting shareholder rights?	X		CL	For class rights, if the shareholders' rights are specified in the Articles of Association then amendment is by special resolution requiring a 75% majority or as provided in the Articles to be passed at a general meeting of the holders of that class. For those involving all members, e.g., reduction of share capital, amendments of memorandum or articles, members voluntary winding up, a special resolutions (75% majority) is required. There is however no specific requirement in the Listing Rules for super majority vote to be obtained for major company acts affecting shareholder rights.
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors? What percentage?	X		SLR, CGC	SGX's Listing Rules state that the issuer's board must have at least two non-executive directors who are independent and free of any material business or financial connection with the issuer. A foreign issuer must further have at least two independent directors resident in Singapore. The Code states that independent directors must make up at least one-third of the Board.
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?	X		CGC	The Code recommends that the Audit committee and the Remuneration committee should comprise majority independent directors.
7. Do independent directors decide what information the board receives from management?		X	CGC	The Code states that Board members should be provided with complete, adequate and timely information prior to board meetings and on an on-going basis. Management has an obligation to supply the Board with complete, adequate information in a timely manner.
8. Are the chairman of the board and chief executive	X		CGC	The chairman and chief executive officer should in principle be separate persons, to ensure an appropriate balance of power,

Element	Yes	No	Source(s) of Rule	Comments
officer different persons in the majority of listed companies?				increased accountability and greater capacity of the Board for independent decision making.
9. Are all board members elected annually?		X	CGC	All directors should be required to submit themselves for re-nomination and re-election at regular intervals and at least every three years.
10. Does the board oversee enforcement of a company code of conduct?	X		GP	
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with International Financial Reporting Standards (IFRS)?	X		SLR	Financial statements must be prepared in accordance with the Singapore Financial Reporting Standards (SFRS) or the IFRS or the US Generally Accepted Accounting Principles. The SFRS are closely modeled after the IFRS.
12. Are the identities of the five largest shareholders disclosed?	X		SLR	The names of the substantial shareholders (5% and above) and a breakdown of their direct and deemed interests must be disclosed in the annual report. For deemed interests, how such interests are held or derived must be disclosed. In addition, for each class of equity securities, the names of the 20 largest holders and the number held must be disclosed in the annual report.
13. Is compensation of company executive officers disclosed?	X		SLR, CGC	SGX's Listing Rules require directors' and key executives' remuneration to be disclosed in the annual report as recommended in the Code.
14. Are extraordinary corporate events disclosed?	X		SLR	An issuer must disclose immediately all information necessary to avoid the establishment of a false market in its securities or that would be likely to materially affect the price or value of its listed securities.
15. Are risk factors disclosed in securities offering materials?	X		SL	Section 243 of the Securities and Futures Act states that a prospectus for an offer of securities shall contain all the information that investors and their professional advisers would reasonably require to make an informed assessment.
16. Are transactions of a company with its insiders disclosed?	X		SLR	An issuer is required to make an immediate announcement of any transaction with its insiders (interested person transaction) of a value equal to, or more than, 3% of the group's latest audited net tangible assets.  The issuer is further required to disclose the aggregate value of interested person transactions entered into during the financial year under review in its annual report.

Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory

# Chinese Taipei

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in Chinese Taipei

#### 1.1 Background

The legal basis of corporate governance in Chinese Taipei primarily arises from the application of Company Law, Securities and Exchange Act, and the listing rules of Taiwan Stock Exchange (TWSE) and Chinese Taipei's computerized over-the-counter market (known as GreTai Securities Market, GTSM). The Company Law particularly aims to standardize companies' operation, for example the function of board of directors and supervisors. As for the Securities and Exchange Act, it emphasizes on public companies' information disclosure, independent director and audit committee system, and enhances the independence of directors and supervisors.

To provide a guideline on corporate governance for the listed company, TWSE and GTSM has setup the Corporate Governance Best-Practice Principles for TWSE/GTSM Listed Companies. The regulator have required the listed companies to disclose in the public offering prospectus and annual report the state of the company's implementation of corporate governance, any departure of such implementation from the Best-Practice Principles, and the reason for any such departure.

#### 1.2 Trends

The table below indicates the trend in the number of listed companies and market capitalization at year-end 2005-2009.

	2005	2006	2007	2008	2009
Number of companies	1,194	1,219	1,245	1,257	1,287
Market Capitalization (NT\$ billion)	16,946.32	21,276.42	23,396.07	12,478.64	22,947.86

During the 2008 global financial crisis, the market capitalization declined 46.67% from year-end 2007 to 2008 and increased 45.62% from year-end 2008 to 2009.

#### 1.3 Key Corporate Governance Rules and Practices

Please refer to Key Corporate Governance Rules and Practices in Chinese Taipei, p. 212.

## **2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules**

### **2.1 Development of Corporate Governance Rules**

In 2002, the Executive Yuan of Chinese Taipei declared corporate governance as Chinese Taipei's important policy and established an inter-ministerial Reform Team of Corporate Governance, which comprising of representatives from Scholars, Ministry of Economic Affairs, Ministry of Finance, Ministry of Justice, TWSE, GTSM, Securities & Futures Institute (SFI), Corporate Governance Association (CGA) and Taiwan Securities Association (TSA). The Reform Team facilitates the promotion of Corporate Governance through integrated planning and gradual movement.

### **2.2 Enforcement of Corporate Governance Rules**

In order to implement corporate governance, the Financial Supervisory Commission (FSC) of Chinese Taipei has established a legal framework for corporate governance. The FSC amended the Securities and Exchange Act and authorized the related rules to require public companies to implement corporate governance. If the public company violates the rules, it may get the penalty and should rectify within the specified period. TWSE and GTSM have required the listed company to enhance corporate governance through the enforcement of listing contract.

Chinese Taipei has enacted the Securities Investor and Futures Trader Protection Act and then founded the Securities and Futures Investors Protection Center. The Protection Center is allowed to institute an action against the director or supervisor on behalf of the company, or to institute a lawsuit in court for an order dismissing the given director or supervisor. Besides, in order to enhance the corporate governance, the Corporate Governance Best-Practice Principles for Financial Industry has requested the bank, the insurance company, the securities firm and the investment company to consider the invested companies' corporate governance when executing investment decision.

### **2.3 Assessment of Corporate Governance Practices**

In 2002, Chinese Taipei has observed the OECD Principles of Corporate Governance and announced the Corporate Governance Best-Practice Principles for Listed Companies. The six principles (establishing an effective corporate governance framework, protecting shareholders' rights and interests, strengthening the powers of the board of directors, fulfilling the function of supervisors, respect stakeholders' rights and interests, and enhancing information transparency) introduced in the Best Practice are in line with OECD principles. In addition, CGA conduct the Corporate Governance Framework Certification System. The methodology used to assessing the implementation of corporate governance observes the OECD Principles as well.

SFI conducts the Information Transparency and Disclosure Ranking among all the listed companies annually. This year will be the seventh year that it has done so. The ranking result for 2009 indicated 362 companies with a grade A and above among all the listed companies.

## **3. Awareness and Advocacy for Good Corporate Governance**

### **3.1 Company Directors**

Many professional training institutes, including SFI, CGA, Accounting Research and Development Foundation, The Institute of Internal Auditors, Taiwan Development & Research

Academia of Economic & Technology, Computer Audit Association, and Taiwan Academy of Banking and Finance, hold corporate governance training courses for directors.

Board of Directors' club, organized by CGA, consists of members representing directors, independent directors, supervisors or executive officers of listed companies in Chinese Taipei. The club holds conference every two months, inviting authority officers and scholars to discuss corporate governance issues.

In accordance with TWSE/GTSM Listing Rules, completion of three hours training courses of directors and supervisors is a prerequisite for listing. Under "Corporate Governance Best-Practice Principles for TWSE/GTSM Listed Companies", new member of the boards should take at least 12 hours of training course and at least three hours of continued training courses every year in his/her term. Moreover, listed companies should disclose the hours of training of directors and supervisors in annual reports, prospectuses and the Market Observation Post System (MOPS) on an ongoing basis.

### **3.2 Media**

The financial authority monthly publishes the Financial Outlook Monthly. It also cooperates with TWSE, GTSM, SFI and CGA to edit a bi-monthly publication "Introduction in Development of International Corporate Governance", which covers the latest developments in corporate governance and other financial information. CGA also publishes monthly and quarterly newspaper updating the latest corporate governance events.

### **3.3 Educational System**

Courses on corporate governance are offered in most of the top business schools and law schools in Chinese Taipei. They are available in both tertiary and higher education program.

Corporate governance is also a critical subject of the on-the-job training program for judges and prosecutors who handle securities cases, which are provided by the Judges and Prosecutors Training Institute of the Ministry of Justice.

### **3.4 Stock Exchange**

Both TWSE and GTSM regularly invite directors of listed companies to attend conferences or training courses on corporate governance. The Exchanges also supports the Taiwan Corporate Governance Association and other organizations advocating corporate governance.

## **4. Corporate Governance of State-Owned and Family-Controlled Enterprises**

### **4.1 State-Owned Enterprises**

The governing bodies that oversee the State's investments in companies are the Ministry of Economic Affairs, the Ministry of Finance, and the Ministry of Transportation and Communications, etc. In addition to the Company Act and Securities and Exchange Act, state-owned public companies have to follow regulations on government units such as the Administrative Law of State-Run Enterprise, Budget Act, Accounting Act, and Financial Statement Act.

The government not only exercises its shareholders' right actively, but also monitors and evaluates performance regularly, will act as director or supervisor once elected, and will setup the guideline to assign, manage, and evaluate the proxies that exercise the duty on its behalf.

The government has also continuously encouraged the state-owned companies to enhance its corporate governance or to privatize. Chunghwa Telecom and China Steel are examples of excellence in corporate governance and performance. Both of them have already received good corporate governance certificates from CGA. The State-owned Enterprise Commission under Ministry of Economic Affairs has also deputed CGA to conduct corporate governance assessment among five state-owned companies.

## **4.2 Family-Controlled Enterprises**

Chinese Taipei's corporations have the features of family-controlled companies, whereby the ownership overlaps with the management power. Therefore, the major corporate governance issue is the prevention of abuse of board of directors' power and full disclosure of related-party transactions. Some family-controlled companies prefer not to go public due to the degree of information disclosure required for public companies. However, there are many examples of successful family-controlled companies that are also listed companies which actively promote corporate governance. A number of them have received the certificate of good corporate governance from CGA.

## **5. Role of Professional Service Providers in Corporate Governance**

- Accounting and auditing firms: the financial reports of a public company shall be duly audited and certified by a CPA. A CPA will evaluate a company's internal control including its board of directors' meeting procedures and propose improvements or suggestion to correct any defect in the course of auditing procedure, and as a result enhanced the implementation of corporate governance.
- Rating agencies: rating agencies in Chinese Taipei focus on operational risk and financial risk. Good corporate governance is one of the elements of good credit rating.
- Commercial banks: One of the key criteria for banks when making investment decisions is to consider the corporate governance performance of potential investment targets.
- Securities analysts: securities analysts focus on the business and financial performance when doing research on a company and deciding whether to introduce it to investors. Corporate governance issues within the company will also emphasized as well.
- Law firms: law firms are usually hired by companies to consult on compliance issues. Law firms advise companies on how to comply with the corporate governance regulations, and the remedy and penalties measures in case of violation.
- Corporate governance consultants: CGA plays a key role in assisting enterprises to setup good corporate governance systems.

## **6. Recent Developments in Corporate Governance**

### **6.1 Corporate Governance Developments**

The 2006 amendment of Securities and Exchange Act introduced the independent directors and audit committee system. It also reinforced the independence of directors and supervisors, improved the quality of information in annual reports and public offering prospectus, and enhanced information disclosure on Market Observation Post System by creating a corporate governance and financial watch-list column.

Furthermore, to protect the minority security holders, Chinese Taipei has amended the Company Act to include the right of minority shareholders to propose agenda items at the shareholder meetings, to nominate director and supervisor candidates, to be able to execute their voting right through electronic forms, and to strengthening shareholders protection.

## **6.2 Enforcement of Corporate Governance Rules**

In 1992, Chinese Taipei has announced the Securities Investor and Futures Trader Protection Act to introduce class-action litigation or arbitration. To further protect the investors and actively exercise protection institutions' rights, Chinese Taipei amended the Act in 2009 to allow an action against the director/supervisor on behalf of the company and to dismiss the given director/ supervisor. As a result, Chinese Taipei has further enhanced shareholder protection.

## **6.2 Current Issues and Challenges for Corporate Governance**

### ***Challenges***

In 2009, foreign investors represented 16.3% of securities transaction in the Chinese Taipei stock market in terms of trading value, an increase from 3.6% in the year 2000. With more and more foreign investors entering, Chinese Taipei appreciates opinions on good corporate governance from foreign investors or experts to improve practices. For example, foreign investors like to have information on shareholders' meeting as early as possible. However, Chinese Taipei has to balance the interests of companies and shareholders, communicate with both and improve practices in line with international trend.

### ***Priorities for Reform***

The priorities for reform are to enhance information disclosure, align the accounting standards with international standards, and encourage shareholders to execute their voting rights through the use of electronic forms, strengthen the market monitoring system and promote enterprises that value social responsibility.

### ***Financial Crisis***

Since the global financial crisis, Chinese Taipei has become more aware that risk management and risk diversification are of great importance and the government has worked on the amendments to the code of best practice for listed companies on corporate governance. The amendment has been announced in 2009 and 2010. Listed companies are strongly encouraged to set up a risk management committee and compensation committee. Then, executive compensation should be disclosed, and should reflect his/her personal contribution, long-term performance and risk. Finally, continuing education for directors and supervisors of listed companies should include risk management issues.

## Key Corporate Governance Rules and Practices in Chinese Taipei

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for shareholders' meetings?	X		CL	Normally – Shareholders are entitled to propose items of agenda at a regular shareholders' meeting since 2005.
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		CGC	Normally – Shareholders shall be granted reasonable time to deliberate each proposal and afforded an appropriate opportunity to make statements.
3. Must company transactions with its insiders be on a non-preferential basis?	X		CGC	Normally – Listed companies that have transactions with related parties must be on a reasonable and fair basis, and tunneling of profits is strictly prohibited.
4. Is a super majority vote required for major company acts affecting shareholder rights?	X		CL	Normally – According to Company Act article 185, super majority vote is required for major company acts affecting shareholder rights.
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors? What percentage?	X		SL SLR	Normally – 1) Public financial holding companies, their subsidiary securities firms, banks, bills dealers, insurance companies, all listed securities firms and non-financial companies with their capital size over NT\$50 billion are required to have at least two independent directors and be no less than one-fifth of the board. Other companies are encouraged to elect the independent directors. (2) Companies that would like to become listed need to have at least two independent directors.
6. Do independent directors have significant influence over (a)internal and external audit and (b)executive compensation?	X		SL CGC CL	Normally – Such matters need to be determined by Board and when an independent director has a dissenting opinion or qualified opinion, it shall be noted in the minutes of the directors meeting and be disclosed on the Market Observation Post System within two days.
7. Do independent directors decide what information the board receives from management?		X		Independent directors receive the same information from management.
8. Are the chairman of the board and chief executive officer different persons in the majority of listed companies?	X		CGC	Normally – There are around 82% of the listed companies having different person as its chairman and CEO.
9. Are all board members elected annually?		X	CL	The term of office of a director can be as long as three years according to the Company Law.
10. Does the board oversee enforcement of a company code of conduct?		X	CGC	Employee are encouraged to report to supervisor or head of internal auditor if discover violating code of conduct case.
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with IFRS?		X		FSC announced that the listed company will need to convert from TW GAAP to IFRS beginning 2013.
12. Are the identities of the five largest shareholders disclosed?	X		SL	Normally – A listed company is required to disclose the company's 10 largest shareholders in its annual report.
13. Is compensation of company executive officers disclosed?	X		SL	Normally – Listed companies have to disclose compensation of their CEO & vice-CEO in their annual report.
14. Are extraordinary corporate events disclosed?	X		SL	Normally – Company need to disclosed the information that are material to shareholders' right or

Element	Yes	No	Source(s) of Rule	Comments
				stock market price
15. Are risk factors disclosed in securities offering materials?	X		SL	Normally – Companies are required to disclose risk in public offering prospectuses.
16. Are transactions of a company with its insiders disclosed?	X		SL	Normally – Listed companies have to disclose transactions with insiders in their financial report. If the transactions related to real property, companies are required to disclose on Market Observation Post System within two days. The system also provided the Related Party District for companies to disclose such information.

*Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory*

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# Thailand

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in Thailand

Anyone who lived through the Asian financial crisis of 1997 has witnessed the rising trend of good corporate governance. This is both understandable and indispensable. Weak corporate governance had exacerbated the economic turmoil of the past decade. To prevent history from repeating itself, Securities and Exchange Commission, Thailand (SEC) set out on a mission to improve corporate governance practices in the capital market and regain confidence of local and international investors.

A decade later, thanks to the collective efforts of all parties concerned, Thailand has covered a lot of mileage in its drive towards international standard corporate governance. For starters, the SEC corporate governance working group set up in 1998 proposed a strategic outline for corporate governance practices of listed firms covering five key areas in need of improvement. They are:

- **Regulatory Reform** with special emphasis on protection of investors' rights;
- **Checks and Balances** across the company board for the best interest of stakeholders;
- **Information Disclosure** with more transparency, accuracy and sufficiency;
- **Market Mechanism** such as shareholder activities, corporate governance rating and educational programs for both company directors and investors; and
- **Effective Enforcement.**

The government announced 2002 the Year of Good Corporate Governance and the Cabinet appointed the National Corporate Governance Committee (NCGC) chaired by the Prime Minister, which consisted of representatives from government and the private sector. The committee's role is to lead the effort to strengthen investor confidence in listed firms and market intermediaries, synchronize corporate governance development plans and monitor performance of relevant agencies.

In 2005, Thailand underwent a corporate governance assessment by the World Bank under the Corporate Governance Report on the Observance of Standards and Codes (CG-ROSC). The CG-ROSC indicates that Thailand's observance of international practices of corporate governance is 69% largely observed and 31% partially observed. Since then the SEC has taken steps to address those areas of weakness identified by the assessment. These include a convergence of Thai accounting standards with the International Financial Reporting Standards (IFRS) and enactment of laws to provide more protection for minority shareholders.

#### 1.1 Listed Companies and Market Capitalization

There are two markets on which companies are listed. The main one is the Stock Exchange of Thailand (the SET), and the other is the market for small and medium size enterprises called the Market for Alternative Investment (the MAI). In March 2010, there were 475 companies

listed on the SET, compared with 468 companies in 2005. As for MAI, there were 60 companies in March 2010, compared with 36 companies in 2005. There is no foreign listing on either market. Market capitalization of the SET was US\$195.9 billion in March 2010, up from US\$124.4 billion in 2005, while market capitalization of the MAI was US\$1.2 billion in March 2010, up from US\$300 million in 2005.

#### No. of Listed Companies and Market Capitalization of SET and MAI

Year	SET		MAI	
	No. of Listed Companies	Market Capitalization (USD mil)	No. of Listed Companies	Market Capitalization (USD mil)
2000	381	29,489	-	-
2001	382	36,356	3	10
2002	389	46,074	9	88
2003	408	120,895	13	346
2004	440	116,184	24	301
2005	468	124,424	36	349
2006	476	143,264	42	615
2007	475	222,911	48	1,285
2008	476	102,712	49	638
2009	475	175,999	60	1,173
Mar.2010	475	195,878	60	1,183

*Source: Stock Exchange of Thailand, and Bloomberg The Next Steps*

## 1.2 Three Pillars of Success

Key success factors for corporate governance development in the capital market are:

### 1. Regulatory Discipline

Many steps have been taken to improve the regulatory framework of the Thai capital market which is based on the Securities and Exchange Act (SEA), the Public Limited Companies Act (PCA) and regulations under the SEC and the Stock Exchange of Thailand (SET). In 2008, the amendments to the SEA came into force, providing clearer scope of fiduciary duties, stipulating sanctions for breaches of those duties, and strengthening the rules governing related party transactions including stronger protection for investors' interests. The Ministry of Commerce's proposed amendment to the PCA is being reviewed by the Council of State while the draft Bill amending the PCA would put in place additional mechanisms to protect investors' rights.

The SEC also proposed a class action bill which would enable shareholders and investors to pursue lawsuits against directors for breaches of duties more conveniently and cost-effectively. The draft bill is being reviewed by the Council of State.

In addition, to enhance corporate governance of listed companies, the SEC and the SET issued several regulations. For example,

- All listed companies are required to have independent directors composing of at least one-third of board size and audit committee composing of at least three members, including all independent directors. Duties of the committee are to review the reliability of financial statements, comment on whether transactions are fair and in the best interest of the company, review the sufficiency of internal control systems, etc.

- Substantial related-party transactions must be approved by shareholders and disclosed in the annual report.
- All listed companies must submit quarterly financial statements and the annual statement has to be audited by accredited auditors while the quarterly statements have to be reviewed.
- To put the IFRS convergence in place, the Federation of Accounting Professions (FAP) has revised the Thai accounting standards so that they comply with IFRS.
- To encourage companies to follow CG guidelines, listed companies are required to disclose in their annual reports whether they comply with the Principles of Good Corporate Governance for Listed Companies. Any non-compliance has to be thoroughly explained (comply or explain).

## **2. Market Discipline**

Investor activism is another main factor in encouraging listed companies to comply with good corporate governance practices. The measures that have been undertaken are as follows:

- As institutional investors (i.e. mutual funds, private funds, and provident funds) are a catalyst for fortifying good corporate governance practices among listed companies, the SEC issued rules requiring asset management companies to exercise their voting rights on all agendas that may affect shareholders or share value at the shareholder meetings of listed companies. Consequently, asset management companies must disclose guidelines of their proxy voting for investors' review. In addition, the voting record must also be disclosed in their websites annually.
- On the retail investor side, the Thai Investors Association (TIA) is the representative of investors, with one board lot shares in every listed company to gain access to shareholders meetings. If TIA sees inappropriate proposals, it may solicit proxy from investors to counter vote the major shareholders. In addition, since 2006, the SEC, in cooperation with the TIA and the Thai Listed Companies Association (TLCA), has conducted an assessment of the Annual General Meeting (AGM) to increase awareness of listed companies about the importance of AGM and to encourage shareholders' active participation. The SEC also provided an AGM checklist as a best practice guideline for listed companies. Over the last four years, most listed firms have made continuous progress as seen from the number of companies achieving good or higher score increasing from 52% in 2006 to 81% in 2009.
- Since 2001, the Thai Institution of Directors' Association (IOD) has conducted corporate governance surveys of Thai listed companies, which are based on the Principles of Corporate Governance of the OECD. The objective of this survey is to review the governance practices of Thai firms. The overall survey results were published in a report entitled "Corporate Governance Report of Thai Listed Companies (CGR)" and publicized to all listed companies and concerned parties in the capital market. The reports have helped Thai listed companies to significantly improve their corporate governance practices, as can be seen from the overall average score, which increased from 50% in 2001 to 75% in 2008. In 2009, the IOD conducted a survey of 290 listed companies and the results showed an average score of 82%.
- Since 2008, the SEC has taken the further step of requesting every securities company to include corporate governance performance assessment according to this CGR in their securities analysis reports. In 2009, all Thai securities companies have already disclosed result of the CGR in their research papers. This has made the report more valuable and widely used by the parties concerned. At the international level, several institutes of directors in the region adopted the Thai IOD criteria in conducting surveys. In the future, the CGR will be developed to be a CG rating, which will enable investors to differentiate the good governance companies from the rest and can then attach higher value to those firms.

To increase awareness of good corporate governance via the media, the SEC and the SET regularly use several communication channels such as websites; publications; articles in newspaper; magazines; television programs; and exhibition to disseminate news and information about the Thai capital market including the elements and benefits of good corporate governance. In addition, specific issues the SEC and the SET will use channels such as the SET's column in the PostToday newspaper named "Enhancing Business with Corporate Governance", the SEC's column in Manager newspaper named "Think Out Loud with the SEC", the SEC's TV program on Money Channel named "Inside SEC". In the past several years, the financial newspapers have paid attention in corporate governance by regularly report on corporate governance issues such as transactions concerning acquisitions or disposal of major assets, the related-party transactions, results of shareholders' meetings and corporate governance enforcement.

### **3. Self Discipline**

Self discipline is another important driver of good corporate governance. The SEC, the SET and other institutions have provided guiding principles and codes of best practice for listed companies to enhance their corporate governance practices.

The Principles of Good Corporate Governance is one such guiding principle. In 2006, the SET launched the Principles of Good Corporate Governance, which was an updated version of the previous 15 Principles of Corporate Governance announced in May 2002. More principles have been added so that it is comparable to the Principles of Corporate Governance of the OECD. The 2006 version included recommendations made by the World Bank in its CG-ROSC. All listed companies must disclose their implementation regarding the principles in their annual registration statement and annual report.

The SEC, the SET and other professional institutions have provided many guidelines and codes of best practice for good corporate governance. For example: Director's Handbook; Financial Advisor Due Diligence; Nomination Committee Guidelines; Remuneration Committee Guidelines; Corporate Governance Self Assessment; Best Practice of Shareholders; Code of Best Practice for Directors of Listed Companies; Audit Committee Checklist, Director Compensation Best Practices, Director Nomination Best Practices; Internal Control Checklist; Q&A: Risk Management, etc.

In addition, educational programs and seminars for market participants are essential mechanisms to create awareness and understanding in the capital market. To date, many series of training programs have been introduced by related organizations:

- In 1999, Thai IOD was set up to provide several training programs for developing professional standard of directorship and provided best practice guidelines for company director to perform their duties effectively and to international standards. Over the last decade, Thai IOD has offers various training programs for directors, audit committees, chairmen and other key persons in listed companies, for instance, Director Certification Program, Audit Committee Certification Program, Financial Statement for Directors, and Company Secretary Program. To date, more than 3,500 directors of listed companies have attended one or more IOD classes.
- In 2002, the SET established the Corporate Governance Center (CG Center) to help listed companies achieve good corporate governance. CG Center provides free consulting services and exchanges ideas about corporate governance practices with directors and executives of listed companies.
- The SET also established the Thailand Securities Institute (TSI) to provide an educational program for investors. It offers training and seminars to enhance the levels of financial and

investment literacy of the investors and other market participants. Additionally, TSI has established a “Train the Trainer” project, designated for professors in Economics, Finance, and Investment fields in academic institutions and experts in financial and capital markets, who are key conduits of knowledge for the general public.

- Recognizing that the legal issues in disputes under the SEA are complex and require specialized knowledge of capital markets and the law, training is mandatory for new judges. In this regard, the SEC provides annual training to existing judges and to the Office of the Attorney General (OAG).
- In recent years, several Thai universities have introduced courses concerning corporate governance. Some universities even provide education programs dedicated to corporate governance courses such as Doctor of Philosophy Program in Good Governance Development, Chandrakasem Rajabhat University; and Master of Science Program in Corporate Governance, Chulalongkorn University.

## 2. Corporate Governance Development in Financial Institutions

*Commercial banks:* realizing the possibility of adverse effects that financial institutions may have on the economy and general public, the Bank of Thailand (BOT) has continued to enhance high standards of corporate governance to the financial institutions. The followings are examples of the BOT measure to promote good corporate governance:

The Financial Institutions Business Act of 2008, provides the BOT authority to define the appropriate structure of the board of directors and sub-committees of the financial institutions to establish checks and balances. Further, the appointment of directors and top executives and management of financial institutions must receive approval from the BOT. According to the BOT regulations, to gain approval the executives and management must hold fit and proper qualifications in three aspects including (1) honesty, integrity, and reputation (2) competence, capability, and experience; and (3) financial soundness.

Additionally, the board of directors of financial institutions must have main duties in four major areas including risk management, monitoring the capital adequacy, rules and regulations compliance and overseeing the good corporate governance.

*Insurance companies:* the Office of Insurance Commission (OIC), regulator of all insurance companies, promotes corporate governance in the insurance sector. Several notifications, guidelines, and best practices have been issued:

- Regulations on rules and procedures to formulate policy on internal control systems and investments of the insurance companies;
- Regulations on criteria on approving external auditors of insurance companies;
- Regulations on the scope of external audit on assessing internal control and investments of insurance companies;
- Insurance companies’ director handbook; and
- Internal Audit Guidelines

### 3. Corporate Governance of State-Owned Enterprises

The State Enterprise Policy Office (SEPO) plays an important role in regulating and supporting state enterprises in order to ensure their good corporate governance and competitiveness, and in enabling them to become tools for Thailand's sustainable development. Currently, there are 58 state enterprises in nine sectors with the total assets of B6 trillion and the ability to generate total revenue of B2.7 trillion a year. However, in today's competitive market, SOEs can no longer rely on traditional ways of management. They must be able to effectively cope with dynamic environments, economic globalization and technological development. The SEPO has initiated guidelines and strategies to create incentives for continuous improvement:

- Reformation and recovery plan for under-performed state enterprises
- State Enterprise Performance Appraisal system (SEPA)
- Remuneration system
- State Enterprise Awards (SOE Awards)
- State Enterprise Review (SER)

In addition, the SEPO has developed "guidelines on good governance for state enterprises", which were granted the cabinet approval on 16 February 2001. These guidelines introduce mechanisms for creating transparency and effectiveness in the administrative system of state enterprises using six standards:

1. Accountability: responsibility for outcomes of the organizational performance;
2. Responsibility: duties are performed with sufficient ability and efficiency;
3. Equitable treatment: all stakeholders must be treated equally;
4. Transparency: assessment of the overall operation and information disclosure;
5. Vision: creation of long-term value without compromising short-term capability; and
6. Ethics: good corporate governance and business ethics.

In 2009, SEPO revised the guidelines to be comparable to OECD Guidelines on Corporate Governance of State-Owned Enterprises 2005. And the cabinet approved the updated guidelines on 3 June 2009.

In order to ensure that the appointed board member has appropriate skills and knowledge. SEPO introduced a directors' pool in 2008, a list of specialists with the requisite knowledge, skills and expertise. The qualifications of experts in the directors' pool must comply with the principles and procedure of the directors' pool approved by the cabinet. In this regard, the General Qualifications of Member and Official of State Enterprise Act, B.E. 2518 (1975) and its Amendment (No. 6) B.E. 2550 (2007), stipulates that at least one-third of board members of the SOE who are not ex officio of any state enterprise shall be selected from the directors' pool of the Ministry of Finance.

### 4. The Role of Professional Service Providers

#### Audit firms

The SEA requires listed companies to submit both quarterly financial statements and financial statements for any accounting period, reviewed or audited (as the case may be) by an auditor. Moreover, the SEA also requires that auditors must be on the approved list of the SEC. Auditors who perform their duties to a professional standard will enhance the investors' confidence in the financial reports.

## Securities analysts

The SEC promotes good corporate governance among listed companies by encouraging securities companies to consider corporate governance practices in listed companies in which they invest. As mentioned earlier, starting in 2008 the SEC requested securities companies in to include a corporate governance scorecard devised by the CGR in their reports.

## Credit Rating Agency

Currently there are two approved credit rating agencies in Thailand, TRIS Rating Co., Ltd and Fitch Ratings (Thailand) Ltd. The rating methodology covers two main components; (1) business risk, encompassing an analysis of the industry and the business itself; and 2) financial risk, primarily focusing on quantitative factors, such as financial ratios, and qualitative aspects ranging from accounting practices to financial policy. The business risk criteria include corporate governance factors, such as management quality and transparency and organization structure.

# 5. Enforcement of Corporate Governance Rules

The SEC, the SET, and other enforcement agencies have implemented several actions to enhance the enforcement. For example:

- **Unfair securities trading:** the SET monitors and investigates securities trading practices. Irregular practices that may violate the securities law, are sent to the SET proposed such cases to the SEC for deliberation;
- **Related-party transactions:** the SEC closely monitors related-party transaction/material transactions deemed as acquisition or disposal of assets in order to deter inappropriate transactions that may cause improper benefit transfers. Should the SEC find ambiguous transactions, or an intention to report false information or concealment of information, it will take immediate action. For example:
  - Requesting the company to submit clear and sufficient information;
  - Encouraging more critical analysis on appropriateness and impacts of ambiguous transactions by issuing a public announcement;
  - Urging investors to attend the shareholders meeting for protection their own interests;
  - In cases of suspected fraudulent transactions, the SEC will conduct in-depth investigations. If there is enough evidence, the SEC will file criminal complaints. As a result of the complaints, affected directors and executives shall not maintain his position in the company;
  - Since financial advisors have a major role in giving independent and professional opinions on transactions, the SEC regularly monitors the performance of their duties to ensure that they adhere to the governing rules, as well as the professional standards. The SEC also imposes punitive measures on financial advisors who fail to fulfill their duties in accordance with the rules;
- **Financial statement:** The SEC, in cooperation with the Federation of Accounting Professions (FAP), extensively monitored auditors' performance. 100% of auditor reports on the submitted financial statements are reviewed. If any suspicion arises, the SEC will also review their working papers to ensure that the financial statements are reliable and comply with the Thai accounting standards. For non-complying companies, the SEC will order them

to make appropriate amendments as well as impose sanctions on the auditor and companies concerned (including directors and the executives in certain cases).

- ***Cooperation of enforcement agencies:***

- The SEC and the Department of Special Investigation (DSI) of the Ministry of justice strengthened cooperation to enhance the use of both organizations' integrated expertise including the DSI's greater power of investigation to secure facts and evidence for actions against the wrongdoers; and
- The SEC became a full signatory to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of information (IOSCO MMoU) to enhance effectiveness of cross-border enforcement.

- ***Mechanisms for effective enforcement:*** the Amended SEA provides more supportive mechanisms for effective enforcement of the securities law such as whistleblower protection and reward money or any persons who provide information on insider trading or market manipulation, etc.

## **6. Recent Developments in Corporate Governance**

The Thai capital market corporate governance development has progressed significantly as can be seen from several reports such as those conducted by the Asian Corporate Governance Association. However, there are still areas for improvement. For example: the legislation on civil penalties and the class action law, which would help make enforcement of the Securities and Exchange Act more efficient, are in progress; the effectiveness of independent directors and internal control, which would be a substantial factor of check and balance system; and active roles of investors to promote good corporate governance among listed companies.

Corporate governance takes time to evolve and the target keeps moving with the increasing new demands from investors. However, with the strong support from the government and the high level of commitment from the relevant parties, the SEC believes that investors' confidence in corporate governance of Thai listed companies will significantly increase.

## Key Corporate Governance Rules and Practices in Thailand

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
Do shareholders add items to the agenda for shareholders' meetings?	X		CL, SL, CGC	
Does shareholders ask questions of directors at shareholders' meetings and do they receive answers	X		CGC, GP	
Must company transactions with its insiders be on a non-preferential basis?	X		SL, CGC	
<b>Composition and Role of Boards of Directors</b>				
Must boards have independent directors?	X		SL, SLR, CGC	At least one third of the board size shall be independent directors, and in any cases, the number shall not be less than three persons.
Do independent directors oversee (i) internal and external audit and (ii) executive compensation?	X		SLR, CGC	(i) The listing rule requires that an overseeing of internal and external audit is audit committee's functions. Audit committee composing of at least three members, which included all independent directors. (ii) The CG code recommends that an executive compensation should be considered by the remuneration committee. In addition, the majority of the remuneration committee member should be independent directors.
Does an independent director decide what information the board receives from management?		X		The CG code recommends that the chairman of the board and the managing director should set the board meeting agenda together and ensure that all important issues are already included.
Are the chairman of the board and chief executive officer different persons in the majority of listed companies?	X		CGC	The CG Code recommends that roles and responsibilities of the chairman of the board are different from those of the managing director. The board should separate the roles and responsibilities of both positions. In order to achieve a balance of power, the two positions should be held by different individuals. According to the 2008 Corporate Governance Report, it indicated that 86% of listed companies complied with such recommendation.
Are the board members elected annually?		X		The Public Company Act stipulates that a public company has to use cumulative voting for the election of directors but it also allow companies to opt-out. In case of using cumulative voting, the whole board of directors shall be simultaneously elected. However, if an election is not cumulative voting, one-third of directors shall retire.
Does the board oversee enforcement of a company code of conduct?	X		CGC	According to the CG Code, listed companies are required to disclose in their annual reports whether they comply with the Principles of Good Corporate Governance for Listed Companies. Any non-compliance has to be explained in an annual report.
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
Is the identity of the five largest shareholders disclosed?	X		SL	
Is compensation of company executive offices disclosed?	X		SL	The SEC requires that listed companies disclose the remuneration paid to each director and disclose total remuneration paid to executives of the company (remuneration means both of financial and non-financial compensation).
Are extraordinary corporate events	X		SL, SLR	

Element	Yes	No	Source(s) of Rule	Comments
disclosed?				
Are risk factors disclosed in securities offering materials?	X		SL	

*Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory*

# United States

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in the United States

#### 1.1 Background

There are four primary sources of law, regulation and principles that provide the legal and institutional basis of the system of corporate governance in the United States: state corporate law; a company's chartering documents, such as its articles of incorporation and bylaws; the federal securities laws; and the listing rules of US exchanges. These sources interact to provide the US framework for determining and regulating the duties and obligations of a publicly traded company's directors and executive officers and the rights of its shareholders.

*State corporate laws:* There is no federal corporation law in the United States. Instead, each of the 50 states of the US (as well as the District of Columbia) has enacted a corporate enabling statute that provides for the formation of corporate entities and establishes the terms of governance among a corporation's board of directors, management and shareholders. For example, state corporate statutes typically mandate that responsibility for the management of a corporation's business and affairs vests in its board of directors, and typically permit the board of directors to appoint committees having a broad range of power and responsibilities and to select the company's executive officers consistent with its bylaws.

State corporate law consists of both the state corporation statutes and judicial decisions interpreting them. Those judicial decisions, which comprise each state's "common law", have established several key components of the US corporate governance framework, such as a director's duties of care and loyalty,<sup>87</sup> and the business judgment rule used by courts to determine whether a director has breached those fiduciary duties.<sup>88</sup> Because the majority of US public companies have elected to incorporate in Delaware, and Delaware corporate law statutes

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<sup>87</sup> The duty of care requires a director to perform his duties in a manner the director reasonably believes to be in the best interest of the corporation. To fulfill this duty, a director must be properly informed and exercise appropriate diligence when making business decisions and overseeing the management of the company. The duty of loyalty requires that a director make corporate decisions based on the best interests of the company and not on a personal interest that is not shared generally by the company's shareholders. As articulated in recent Delaware case law, the duty of loyalty also subsumes a duty to act in good faith, *i.e.* honestly, in the best interest of the corporation, and in a manner that is not knowingly unlawful or contrary to public policy.

<sup>88</sup> The business judgment rule applies a presumption that when making a business decision, directors have acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company. A plaintiff may rebut this presumption upon proof that the directors breached their duty of care or loyalty or acted in bad faith.

and related jurisprudence are well-developed and followed by other states, this report refers to Delaware corporate law.

**Corporate chartering documents:** A corporation's basic chartering documents are its certificate or articles of incorporation, which are filed with the state of incorporation's secretary of state or other corporate office, and the company's by-laws. State corporate laws typically provide some flexibility regarding the basic chartering documents in order to permit companies to structure their governance as shareholders, directors and management see appropriate. For example, Delaware General Corporation Law (DGCL) Section 212(a) provides that each stockholder is entitled to one vote for each share of capital stock held unless otherwise provided in the company's certificate of incorporation. A corporation's governing documents also may include its corporate governance guidelines, which disclose the standards governing the board's key duties and functions. Many companies have adopted corporate governance guidelines to fulfill exchange listing requirements or voluntarily to reflect best practices.

**US federal securities laws:** The Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act) regulate offerings, sales and trading of securities. The Exchange Act also requires companies that have registered securities with the US Securities and Exchange Commission (SEC) to file periodic and current reports on an ongoing basis. The Exchange Act further regulates the process by which public companies solicit shareholder votes in connection with shareholder meetings.

The SEC has promulgated rules that require a Securities Act or Exchange Act registrant and reporting company to disclose specified information concerning its corporate governance, business, results of operation and financial condition, directors and executive officers, principal shareholders, and other matters. The SEC also has rules that govern proxy solicitation and disclosure in connection with shareholder meetings. In addition, the SEC has adopted rules requiring directors, officers and principal shareholders to disclose their ownership of securities in Exchange Act registrants. The fundamental purpose underlying the SEC's disclosure rules is to help investors make informed investment or voting decisions.

**Listing rules of US exchanges:** To maintain a listing of a security on a US exchange, a company must comply with the exchange's listing rules, which are subject to approval by the SEC. These rules typically include corporate governance requirements.<sup>89</sup> For example, the NYSE requires most listed companies to have a majority of independent directors<sup>90</sup> and nominating, compensation and audit committees, each of which is composed entirely of independent directors.<sup>91</sup> The NYSE has generally justified the independent director requirement in its corporate governance rules based on its view that having independent directors will increase the quality of board oversight and lessen the possibility of damaging conflicts of interest.<sup>92</sup>

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<sup>89</sup> The corporate governance rules of the various US exchanges, including the New York Stock Exchange (NYSE) and Nasdaq, the principal US securities markets, are similar, although there is some variance. This report references the Listed Company Manual of the NYSE.

<sup>90</sup> Section 303A.01 of the NYSE Listed Company Manual.

<sup>91</sup> Section 303A.04, 303A.05 and 303A.06 of the NYSE Listed Company Manual.

<sup>92</sup> See the commentary to NYSE Listed Company Manual Section 303A.01.

## 1.2 Trends

The following chart shows the total number of listed companies and aggregate market capitalization for the primary securities markets (NYSE and Nasdaq) in the United States over the past five years:

	2005	2006	2007	2008	2009
Number of Listed Companies	5,434	5,413	5,366	5,963	5,179
Market Capitalization (in US\$ billion)	17.24	19.29	19.66	11.61	15.10

*Source: Based on statistics compiled by the World Federation of Exchanges*

During the 2008 global financial crisis, market capitalization declined 41% from year-end 2007 to 2008 and increased 30% from year-end 2008 to 2009.

## 1.3 Key Corporate Governance Rules and Practices

See Key Corporate Governance Rules and Practices in the United States, p. 234.

# 2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules

## 2.1 Development of Corporate Governance Rules

The SEC has played a significant role in developing corporate governance rules both directly and, through its oversight of US stock exchanges, indirectly. Areas of corporate governance that have been the subject of final or proposed SEC rules include executive compensation disclosure, comparative corporate governance disclosure by Exchange Act reporting foreign private issuers, proxy disclosure enhancements, proxy access, and a company's internal controls over financial reporting. The SEC has also approved rules adopted by US stock exchanges on a wide range of corporate governance subjects, such as independent director requirements, executive compensation, nominating, and audit committee requirements, and code of ethics requirements.

In its corporate governance rulemakings, the SEC has benefited from comments submitted by independent groups. Those groups have included the Council of Institutional Investors, which is a non-profit association of public, union and corporate pension funds, the Business Roundtable, which is an association of chief executive officers from large US companies, the US Chamber of Commerce, which represents primarily smaller US companies, the American Bar Association, and the American Institute of Certified Public Accountants.

## 2.2 Enforcement of Corporate Governance Rules

During the two-year period of 2008 and 2009:

- The SEC brought a total of 503 civil actions and administrative proceedings against companies to enforce its rules concerning reporting and disclosure, including corporate governance requirements;<sup>93</sup> and

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<sup>93</sup> See the Enforcement Action Summary Charts for Fiscal 2008 and 2009, which are contained, respectively, in Select SEC and Market Data for 2008 and 2009, and available on the SEC's web site at <http://www.sec.gov/about/secstats2008.pdf> and 2009.pdf.

- A total of approximately 390 class action lawsuits were brought asserting claims of violation of the federal securities laws.<sup>94</sup>

In addition, during that same period, approximately 1,250 lawsuits were brought in the Delaware Court of Chancery asserting rights under state corporate law.<sup>95</sup> These statistics do not include lawsuits brought in state courts other than Delaware courts or lawsuits brought individually to assert claims under the federal securities laws.

### **2.3 Assessment of Corporate Governance Practices**

There has not been a self-assessment or ROSC undertaken with respect to observance of the OECD Principles of Corporate Governance in the United States.

## **3. Awareness and Advocacy for Good Corporate Governance**

### **3.1 Company Directors**

The most prominent association of corporate directors in the United States is the National Association of Corporate Directors (NACD). According to NACD's website, its "network includes nearly 10,000 directors and executives from leading public, private and nonprofit companies; economy-wide recognized firms whose professional services meet important corporate governance needs; and governance experts from academia and elsewhere".<sup>96</sup> The NACD develops publications and training for corporate directors, including an annual conference, on matters relating to their corporate governance responsibilities.

In addition to the NACD's director education programs, many other organizations, including universities and other nonprofit organizations, offer director education courses and publications. Examples are: the Director's Consortium, sponsored jointly by the University of Chicago, Stanford University, and Dartmouth College; the University of Delaware's John L. Weinberg Center for Corporate Governance; Duke University's Director's Education Institute; the Conference Board's Director's Institute; the NYSE's corporate forums; the American Society of Corporate Secretaries; and the American Bar Association Section of Business Laws' Corporate Director's Guidebook, now in its fifth edition. There is no mandatory director training regarding these programs, however.

Some US exchanges require a listed company to adopt corporate governance guidelines that address a variety of board issues, such as the qualifications, responsibilities, and compensation of directors. For example, NYSE listed companies must adopt corporate governance guidelines that, in addition to the above topics, must address continuing education requirements for

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<sup>94</sup> The number of federal class action lawsuits is based on statistics compiled by the Stanford Law School Securities Class Action Clearinghouse, in cooperation with Cornerstone Research. Not all of these lawsuits addressed corporate governance issues.

<sup>95</sup> The number of Delaware court lawsuits is derived from statistics contained in the 2009 Annual Report of the Delaware Judiciary. This estimate is based on the assumption that approximately 75% of the civil cases brought in the Court of Chancery are corporate governance cases, as reflected in a survey of earlier data in Robert B. Thompson & Randall S. Thomas, *The New Look of Shareholder Litigation: Acquisition-Oriented Class Actions*, 57 VAND. L. REV. 133, 165–66 (2004).

<sup>96</sup> <http://www.nacdonline.org>

directors.<sup>97</sup> Those guidelines typically encourage directors to attend continuing education programs at the company's expense.

### **3.2 Media**

Some US universities offer programs designed to educate working journalists on business issues, including corporate governance issues. For example, the Rock Center for Corporate Governance at Stanford University Law School awards fellowships to experienced business and finance journalists enabling them to attend a program offering a primer on corporate governance. Columbia University's Graduate School of Journalism annually awards fellowships to experienced journalists seeking to develop their expertise in business matters. Arizona State University's Donald W. Reynolds National Center for Business Journalism provides free training to journalists in an effort to improve the quality of American business journalism. In addition, the Society of American Business Editors and Writers offers continuing education programs on business matters and ethics to its journalist members.

In the United States business and financial journalists regularly report on corporate governance matters. Coverage of corporate governance matters has tended to increase during times of financial and economic crisis, such as following the collapse of Enron and Worldcom in 2002 and the global recession of 2008. Today the US press regularly reports on corporate governance matters in connection with US Congressional efforts to enact financial reform and recent corporate investigations.

### **3.3 Educational System**

While corporate governance has only recently been introduced into curricula at some undergraduate institutions in the US, it is widely available to students in business and legal graduate programs. Corporate governance is not typically a subject taught in US secondary schools (grades 9-12).

Corporate governance is an established part of the MBA curricula at major US universities such as Harvard, Yale, Dartmouth, Stanford, and New York University, either as a mandatory course or an elective. Some MBA programs include corporate governance issues as part of a broader course on corporate responsibility, business ethics and leadership.

Many US law schools offer courses on corporate governance matters. Some US law schools, such as Northwestern University's Corporate Counsel Institute, provide post-graduate training on topics of interest to corporate counsel, including corporate governance.

Members of the judiciary at the federal or state level may also receive training in corporate governance. For example, the Federal Judiciary Center, which provides continuing education and other services to federal judges, has offered courses on US corporate trends and securities regulatory issues. In addition, the judges of the Delaware Supreme Court and the Court of Chancery (the forum with the most concentrated corporate governance docket) typically have records of significant practice experience in transactional and litigation aspects of corporate governance.

### **3.4 Stock Exchange**

The NYSE supports a number of programs that offer continuing education to company directors. Those programs include the director education programs of the NACD and the

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<sup>97</sup> See NYSE Listed Company Manual Sec. 303A.09.

Outstanding Directors Exchange. Nasdaq also supports continuing education for company directors through the Nasdaq OMX Educational Foundation, Inc., which seeks to provide innovative educational and charitable opportunities that support the exchange's mission.

The NYSE periodically sponsors corporate forums that address significant issues, including corporate governance matters, affecting public companies, and which are led by legal, financial, economic, and investor relations experts.

## **4. Corporate Governance of State-Owned and Family-Controlled Enterprises**

### **4.1 State-Owned Enterprises**

US governmental investment in publicly traded companies has been infrequent. However, in response to the 2008 financial crisis, the US government established the Troubled Asset Relief Program (TARP), which authorized the US Treasury to purchase the “troubled assets” of, and invest in, banks and other financial institutions meeting specified conditions. Oversight of TARP is provided by a Financial Stability Oversight Board, which includes the Chairman of the Federal Reserve, the Treasury Secretary, the Chairman of the SEC, the Director of the Federal Housing Finance Agency and the Secretary of Housing and Urban Development. Under TARP's Capital Purchase Program, the US Treasury has injected over \$200 billion of capital in distressed firms in exchange for primarily non-voting preferred securities. Many of those firms have already repaid the TARP investment.

In connection with TARP, the US Treasury Department promulgated executive compensation and corporate governance standards with which participating financial institutions must comply for as long as the US Treasury holds their equity issued under the program. Those standards include: restrictions on the amount of cash compensation and payment of bonuses, retention awards or incentive compensation; prohibition on making “golden parachute” payments; and a “say-on-pay” requirement that shareholders of any TARP recipient be permitted to vote separately to approve the compensation of executives at an annual or other meeting of shareholders.

There are no important CG issues with the way major state-owned enterprises are governed other than the TARP-related issues described above.

While the TARP program is too recent to gauge its long-term effect on corporate governance in the US, the TARP corporate governance-executive compensation standards may be viewed as confirmation of the OECD principle that a company's executive compensation practices should further the long-term interests of the company and its shareholders.

### **4.2 Family-Controlled Enterprises**

Publicly traded companies that are family-controlled are largely subject to the same corporate governance requirements as other US publicly traded companies. Certain corporate governance stock exchange listing standards (such as requiring a majority of independent directors and a nominating committee consisting of all independent directors) do not apply to companies with a controlling stockholder.

While corporate governance requirements might act as a disincentive to a private, family-owned enterprise becoming a listed company, other factors, such as the cost of complying with SEC financial disclosure requirements and producing Exchange Act reports, are at least as significant a disincentive.

## **5. Role of Professional Service Providers in Corporate Governance**

### **Accounting and auditing firms**

Accounting firms seek to ensure that US Generally Accepted Accounting Principles (US GAAP), International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), or GAAP reconciliation requirements are complied with in companies' financial statements. Auditors are responsible for verifying compliance with those accounting standards and requirements, and attesting to management's assessment of the issuer's internal control over financial reporting. By the issuance of an audit report and attestation report, the public is informed of the company's financial performance, compliance with accounting standards, and level of adequacy of the company's internal control over financial reporting. Accountants regularly counsel companies on ways to improve their accounting procedures and controls.

### **Rating agencies**

In recent years, securities rating agencies in the United States, such as Moody's and Standard & Poor's, have included corporate governance compliance as part of the methodology used to rate publicly traded companies. In some instances, those agencies have explicitly informed the public that corporate governance problems have contributed to the rating given to a company's securities. In other instances, those agencies have informed the public that a particular rating is due to its assessment of a company's level of financial risk, which is defined to include a view of a company's corporate governance, financial policies, and risk tolerance. Those agencies have also occasionally published reports that focus on corporate governance assessment and compliance in various industries or regions.

### **Commercial banks**

In response to the recent global financial crisis, the US Congress is considering adoption of a financial reform bill that, among other matters: would require the Federal Reserve Board to adopt rules prohibiting bank holding companies from providing compensation to its directors, executives or employees that is excessive or could lead to material financial loss; would prohibit commercial banks from engaging in proprietary trading and investing in or sponsoring hedge funds and other private equity funds; and would impose new standards designed to address the systemic risk of financial collapse. Banks that are listed companies would have to establish risk committees and disclose to the public their compliance with the new regulation in their SEC reports.

### **Securities analysts**

Securities analysts have increasingly focused on the corporate governance of companies in their analyses of companies' performance and prospects. For example, the Calvert Social Index is a benchmarking tool used by securities analysts to measure the level of social responsibility attained by US listed companies. The Index is comprised of the 1,000 largest companies on the NYSE and Nasdaq, which are then reviewed for their performance in several areas, including corporate governance and ethics.

### **Law firms**

Law firms frequently prepare and review company filings, including Securities Act and Exchange Act registration statements and Exchange Act reports and proxy statements, in order to ensure compliance with applicable statutes and SEC rules. If a company is found not to be in compliance with corporate governance requirements, for example, concerning the fairness of

related party transactions or the company's internal control over financial reporting, the law firm informs the company about the need to remedy the applicable act or omission and assists the company in finding the means to do so. If SEC rules require the disclosure of the non-conforming practice in an Exchange Act report or other SEC filing, the law firm will typically assist the company in fulfilling its disclosure obligations.

### **Corporate governance consultants**

In recent years, due to the myriad reforms in corporate governance that have occurred, US listed companies have increasingly retained corporate governance consultants to help them comply with corporate governance requirements. For example, corporate governance consultants have assisted compensation committees in the review of director and executive compensation and the establishment of compensation practices that are compliant with SEC and exchange requirements. Nominating committees have also sought the assistance of corporate governance consultants to ensure compliance with independent director requirements.

## **6. Recent Developments in Corporate Governance**

### **6.1 Corporate Governance Developments**

The following are examples of significant corporate government developments in the United States during the past three years:

*At the US legislative level*, as previously noted, TARP was adopted and established. In addition, the US Congress is currently considering adopting a financial reform bill that, among other matters, could include: a "say-on-pay" provision mandating that any proxy statement, required by SEC rules to include compensation disclosure, must include a non-binding shareholder resolution approving the company's executive compensation; a requirement that listed companies must have fully independent compensation committees based on new independence standards to be adopted by the stock exchanges; a directive to the SEC to adopt rules requiring disclosure of the relationship between executive compensation actually paid and a company's financial performance; and a provision granting the SEC explicit authority to adopt "proxy access" rules requiring companies to include nominees submitted by shareholders in proxy solicitation materials.

At the US administrative level, the SEC adopted rules:

- To enhance proxy disclosure concerning a number of corporate governance matters, such as whether compensation policies and practices present material risks to the company; whether and why the company has chosen to combine or separate the principal executive officer and board chairman positions, and the reasons why the company believes that this board leadership structure is the most appropriate structure for the company; and the board's role in the oversight of risk;
- To implement the TARP condition that requires companies that have received financial assistance under TARP to permit a separate shareholder advisory vote to approve the compensation of executives, as disclosed pursuant to the compensation disclosure rules of the Commission, during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding; and
- Provide an alternative method for issuers and other persons to furnish proxy materials to shareholders by posting them on an Internet website and providing shareholders with notice of the availability of the proxy materials.

The SEC has also proposed rules that would require a company, under certain circumstances, to include in the company's proxy materials a shareholder's, or group of shareholders', nominees for director.

*At the state legislative level*, in 2009 the Delaware General Corporation Law was amended to add two new sections (112 and 113) that clarify the power of stockholders to adopt bylaws that (i) require the company to include stockholder nominees for election as director in the company's proxy solicitation materials, or (ii) require the company to reimburse a stockholder for costs of soliciting proxies on behalf of one or more nominees for election as director. These provisions have also been followed by similar amendments to the Model Business Corporation Act, which serves as a model for corporate statutes in approximately 30 other US states.

## **6.2 Enforcement of Corporate Governance Rules**

The Delaware Court of Chancery decides hundreds of corporate governance cases every year, and many additional such cases are resolved by settlement or otherwise without generating any judicial opinion. Nevertheless, the following decisions by the Court of Chancery in just the last two months illustrate the regular use of shareholder lawsuits to enforce corporate governance requirements:

*Global GT LP v. Golden Telecom, Inc.*, C.A. No. 3698-VCS (Del. Ch. Apr. 23, 2010): This was a statutory appraisal proceeding arising out of a 2007 merger, with a related party, which prescribed conversion of the minority shareholders into \$105 per share in cash. The court award to the minority shareholders was US\$125.49 per share plus prejudgment interest.

*Air Products & Chemicals, Inc. v. Airgas, Inc., et al.*, Civil Action No. 5249-CC (Del. Ch. 17 March 2010): This ruling ordered that trial begin in September 2010 on claims arising out of corporate management's opposition to a takeover bid and efforts by the bidder to elect new directors.

*London v. Tyrell*, Civil Action No. 3321-CC (Del. Ch. 11 March 2010): The court denied a motion to dismiss shareholder derivative litigation based on the report and recommendation of a special litigation committee of the board of directors, and instead ordered breach of fiduciary duty claims to proceed against certain directors for their approval of and awards under an equity incentive plan.

*In Re Revlon, Inc. Shareholders Litigation*, Consol. C.A. No. 4578-VCL (Del. Ch. 16 March 2010): Finding that lead plaintiff's counsel for the shareholder class had been ineffective, the court appointed new lead class counsel to protect shareholders' interest in litigation challenging a proposed transaction to acquire minority shares of Revlon, Inc.

## **6.3 Current Issues and Challenges for Corporate Governance**

### **6.3.1 Challenges**

One challenge to implementation of good corporate governance in the United States hinges on the fact that historically most US listed companies have adopted a board leadership structure that places the role of chairman of the board in the same person as the company's chief executive officer. Some have expressed concern that this structure impedes the board's ability to assess risk and exercise independent judgment. The SEC has recently adopted rules to address this concern by requiring enhanced disclosure in a company's proxy statement concerning the board's leadership structure and its role in risk oversight.

Another challenge concerns the inability of shareholders to require the inclusion of their director nominees in the company's proxy solicitation materials. Both the US Congress and the SEC are considering ways to address this issue.

### 6.3.2 Priorities for Reform

In the US, the legal and regulatory framework for corporate governance is already in place and is in accord with most international best practices. Nevertheless, both the US Congress and the SEC are aware of the need for improvements regarding various aspects of the legal and regulatory framework for corporate governance. These aspects include executive compensation regulation, board leadership structure, the board's role in risk oversight, and shareholders' rights involving proxy access and proxy disclosure. While the US Congress or the SEC has recently adopted or proposed measures addressing them, these corporate governance matters are likely to continue to present challenges in the years to come.

### 6.3.3 Financial Crisis

The corporate developments described in response to Question 6.1 have emerged to varying degrees out of the recent global financial crisis. They include efforts to: strengthen regulation concerning executive compensation; enhance proxy disclosure; and improve proxy access for the benefit of shareholders. Please refer to the response to Question 6.1 for further discussion of these reform measures and whether they have been implemented.

## Key Corporate Governance Rules and Practices in the United States

Element	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for shareholders' meetings?	X		SL	See Exchange Act Rule 14a-8.
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		GP	
3. Must company transactions with its insiders be on a non-preferential basis?	X		CL	Under Delaware law, fiduciary duty requires insider transactions to be equivalent to transactions negotiated at arms' length. US federal securities regulations also require disclosure of related party transactions exceeding a specified amount.
4. Is a super majority vote required for major company acts affecting shareholder rights?		X	CL	While DGCL generally requires a majority vote for major company acts affecting shareholder rights, a company's chartering documents may require super majority vote for specified acts. SLR may also encourage a super majority vote for specified acts. See, for example, NYSE Listed Co. Manual Sec. 313.
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors? What percentage?	X		SLR	NYSE Listed Co. Manual Sec. 303A.01 requires most listed companies to have a majority of independent directors.
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?	X		SLR	NYSE Listed Co. Manual Secs. 303A.05 and 303A.06 require a listed company to have a compensation committee and an audit committee, the members of which must all be independent.
7. Do independent directors decide what information the board receives from management?	X		CL, SLR	Directors are entitled under state corporate law to have access to all corporate information pertinent to their managerial responsibility. Also, NYSE Listed Co. Manual Sec. 303A.07 requires that, in order to perform oversight

Element	Yes	No	Source(s) of Rule	Comments
				functions effectively, a listed company's audit committee must periodically meet separately with management.
8. Are the chairman of the board and chief executive officer different persons in the majority of listed companies?		X	GP	Although historically, for a majority of US listed companies, the chairman of the board and chief executive officer (CEO) have been the same person, as of 2008 about 39% of S&P 500 companies have appointed a chairman who is different than the CEO, and "lead" non-executive directors are even more common.
9. Are all board members elected annually?		X	CL	Some US listed companies have corporate chartering documents that permit the election of a staggered board of directors.
10. Does the board oversee enforcement of a company code of conduct?	X		SLR	NYSE Listed Co. Manual Sec. 303A.10 requires a listed company to adopt and disclose a code of business conduct and ethics for its directors, officers, and employees.
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with International Financial Reporting Standards (IFRS)?	X		SL	Foreign private issuers' financial statements must comply either with IFRS as issued by the International Accounting Standards Board, US GAAP, or home economy GAAP with US GAAP reconciliation. US companies' financial statements must comply with US GAAP.
12. Are the identities of the five largest shareholders disclosed?	X		SL	Pursuant to Reg. S-K Item 403, US listed companies must disclose each shareholder beneficially owning greater than 5% of voting securities as well as share ownership of directors and named executive officers. Foreign private issuers have similar disclosure obligations under Form 20-F.
13. Is compensation of company executive officers disclosed?	X		SL	Pursuant to Reg. S-K Item 402, US listed companies must disclose on an individual basis the annual compensation of its directors and named executive officers. Pursuant to Item 6.B of Form 20-F, foreign private issuers may disclose annual director and executive compensation on an aggregate basis only if the home economy does not require individual compensation disclosure and individual compensation disclosure has not occurred in the home market.
14. Are extraordinary corporate events disclosed?	X		SL	See, for example, Reg. S-K Items 101 and 303 and Form 20-F Items 4 and 5.
15. Are risk factors disclosed in securities offering materials?	X		SL	See Reg. S-K Item 503 and Form 20-F Item 3.D.
16. Are transactions of a company with its insiders disclosed?	X		SL	See Reg. S-K Item 404, requiring related party transaction disclosure by US listed companies, and Exchange Act Section 16 and related rules requiring specified insiders of US listed companies to report their US listed company share ownership. While Form 20-F Item 7.B imposes similar related party disclosure requirements on foreign private issuers, insiders of foreign private issuers are exempt from Exchange Act Section 16 and related rules.

Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory

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# Viet Nam

## Corporate Governance Institutions, Practices and Developments

### 1. Key Institutional Features of Corporate Governance and Company Profile in Viet Nam

#### 1.1 Background

The legal framework that directly relates to corporate governance includes the Enterprise Law, the Securities Act, the regulations on corporate governance, and the Sample of Charter for listed companies.

##### ***The Enterprise law***

In 1990, Viet Nam promulgated the Corporate Law, the first legal document regulating corporate governance, which then was amended in 1994 and replaced by the Enterprise Law in 1999. In 2005, the National Assembly approved a new Enterprise Law.

The 2005 Enterprise Law regulates the basic rights of shareholders and corporate governance mechanisms including the organization and operation of the general meetings of shareholders, the organization and operation of the Board of Directors, its setting up conditions, criteria and obligations, etc.

##### ***The Securities Act***

The Securities Act was enacted by National Assembly in 2006 and took effect in 2007. It regulates activities related to stock offering for sale to the public, stocks listing, transactions, trading, investment, stocks services and stocks markets.

Conditions for a company to be listed on the stocks market include:

- (i) the amount of charter capital at the time of registering for listing must be more than VND10 billion;
- (ii) business activities in the year preceding the year of listing must be profitable, with no debts overdue by more than a year and with financial obligations to the State fulfilled;
- (iii) the voting shares of the company must be held by at least 100 shareholders;
- (iv) shareholders who are also managers or directors in the company must pledge to hold 100% of their shares for six months after being listed, and 50% of their shares during the subsequent six months.

## 1.2 Trends

Number of companies listed on the stock market and market capitalization as of 31 December for 2005-09.

Year	2005	2006	2007	2008	2009
Number of listed companies	41	193	250	338	453
Market capitalization (US\$ million )	349	6,066	18,834	18,797	28,658

The number of listed companies as well as market capitalization increased has risen continuously since 2005. Market capitalization decreased toward the end of 2007 and through 2008 due to the global financial crisis. However, the number of listed companies continued to increase. By July 2010, the number of listed companies has reached 550 with a market capitalization of VND700,000 billion (equivalent to US\$36.8 billion).

## 1.3 Key Corporate Governance Rules and Practices

See Key Corporate Governance Rules and Practices in Viet Nam, p. 241.

# 2. Development, Enforcement and Assessment of Implementation of Corporate Governance Rules

## 2.1 Development of Corporate Governance Rules<sup>98</sup>

The Ministry of Planning and Investment is the leading agency in charge of drafting the Enterprises Law as well as issuing by-law documents guiding the Enterprise Law.

The Ministry of Finance led the preparation of guiding regulations on corporate governance for the state-owned enterprises as well as regulations on corporate governance for individuals and organizations representing the share of State capital invested in enterprises.

The State Securities Commission (SSC) under the Ministry of Finance is the agency in charge of drafting the Securities Act and is responsible for drafting rules and regulations on corporate governance for public companies and listed companies. SSC is also responsible for the supervision of the implementation of these legal documents.

The Stock Exchange issues listing regulations, among which the implementation of the principles for corporate governance is considered a requirement for listing.

## 2.2 Enforcement of Corporate Governance Rules

The SSC is mandated by the Minister of Finance to perform the function of state management of the stock market; the direct management and supervision of stock market activities; the management of public service activities in the field of stocks and the stock market in accordance with the law.

Since 2007, SSC inspectors have issued 308 sanctions decisions, among which 279 decisions were related to companies. SSC has received many complaints about violation of corporate governance provisions by shareholders of public companies. However, SSC has just found a small number of violations and imposed administrative sanction decisions. For the remaining

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<sup>98</sup> “Rules” refers to requirements for corporate governance however they are designated; e.g., laws, regulations, stock exchange listing requirements, or principles in obligatory codes.

cases, the majority of investors, shareholders and companies tried to resolve disputes through negotiation and internal conciliation settlement.

### **3. Awareness and Advocacy for Good Corporate Governance**

#### **3.1 Company Directors**

Viet Nam currently has no institutions or associations for company directors. The SSC is in the preparatory phase of establishing an Institute of Corporate Governance.

The SCC's Training Center has organized short training courses on corporate governance for the Company Directors of listed companies. To date, the number of Company Directors, members of Supervisor Boards and the managers of public companies who participated in these short training courses on Corporate Governance is around 1,240 persons.

#### **3.2 Educational System**

Corporate governance is included in upper-secondary school curriculum with the aim of providing students with the basic concepts of running a business, choosing a business activity and organizing and managing a business.

At the tertiary level, depending on the curriculum of the individual university, corporate governance is taught as a part of business management or may be a unit in degrees in economics or business administration.

Postgraduate degrees in economics and MBAs may also include corporate governance as a subject or a topic.

#### **3.3 The Stock Exchange**

The SSC conducts an annual conference on corporate governance as well as training workshops and seminars for public companies and listed companies. The Training Center of the SSC offers short-term training courses on corporate governance for the Board Members of listed companies.

The SSC is working with various partners to develop a comprehensive training program on corporate governance at the Training Center of the SSC.

### **4. Corporate Governance of State-Owned Enterprises**

The state management organizations that supervise the public investment projects of State-owned enterprises at the local level are the Provincial People's Committees. (The Department of Planning and Investment, a body of the Provincial People's Committees, is mandated to assist state organizations to perform the task of monitoring public investment projects.)

The state management organizations that supervise the public investment projects of state-owned enterprises at the central level, are the relevant ministries and branches in charge of these enterprises.

## 5. The Role of Professional Service Providers in Corporate Governance

Providers of professional services in Viet Nam have so far played a minor role in relation to corporate governance. In Viet Nam, there are not yet any organizations that provide credit ratings. The role of law firms, commercial banks and consultants in this regard is unclear.

However, independent auditing companies and stock brokerages have been supporting customers in the provision of market information, helping to ensure compliance of legal requirements in relation to corporate governance.

## 6. Recent Developments in Corporate Governance

### 6.1 Corporate Governance Developments

Since the enactment of the 2005 Enterprise Law, there has not been any new major development in corporate governance in Viet Nam.

### 6.2 Enforcement of Corporate Governance Rules

Most violations and enforcement actions in Viet Nam have occurred in the stock market. However, no case has been brought to the courts. As mentioned earlier, the SSC has discovered a small number of violations and imposed administrative sanctions. For the remaining cases, the majority of investors, shareholders and companies try to resolve disputes through internal negotiation and conciliation procedures.

### 6.3 Current Issues and Challenges for Corporate Governance

#### 6.3.1 Challenges

Viet Nam has faced many challenges in the process of promoting the understanding of, and compliance with, better standards and practices of corporate governance. The legal framework and regulations governing corporate governance are deficient and incomplete; corporate governance is regulated by laws and regulations which are sometimes inconsistent or even conflicting.

The enforcement capability of state management agencies and the court system require significant improvement. Managers do not have sufficient experience, education or understanding about corporate governance issues.

Moreover, the understanding of investors and shareholders is still limited; they are not fully aware of their rights, do not participate actively in the corporate governance of enterprises in which they invest and they are not fully aware of relevant procedures and measures when their rights have been violated.

According to the Enterprise Law, state-owned companies must be converted into limited liability companies or joint stock companies by 1 July 2010 at the latest. Currently, there are many state-owned companies that have yet to comply with this regulation.

#### 6.3.2 Priorities for Reform

The priorities for reform include: (i) further improvement of the legal framework and regulations on corporate governance; (ii) strengthening the enforcement capacity of the state enterprise system and the court system; (iii) wider implementation of programs to raise awareness on corporate governance for enterprises and investors; and (iv) the establishment of a National Committee for Corporate Governance.

### 6.3.3 Financial Crisis

Most of proposals for reform emerged following the recent global financial crisis, when the implications for corporate governance as it relates to macroeconomic stability, especially in the financial sector, became better understood. Viet Nam needs to strengthen financial supervision and enhance risk management; separate the management functions and ownership representation function; and continue the equitization process of state-owned enterprises.

## Key Corporate Governance Rules and Practices in Viet Nam

Criteria	Yes	No	Source(s) of Rule	Comments
<b>RIGHTS OF SHAREHOLDERS</b>				
1. Do shareholders add items to the agenda for shareholders' meetings?	X		CL	Shareholders or group of shareholders holding over 10% of ordinary shares within six consecutive months or a smaller ratio as stipulated in the Charter of the company are entitled to do so (Article 79, Article 99)
2. Do shareholders ask questions for directors at shareholders' meetings and do they receive answers?	X		CL	
3. Must company transactions with its insiders be on a non-preferential basis?	X		CL	Article 119 and 120
4. Is a super majority vote required for major company acts affecting shareholder rights?	X		CL	Implementation of the provisions of the overwhelming votes reduces the imposition of major shareholders to small ones, enabling small shareholders to discuss and to have a say in the resolutions of the Shareholders' General meeting.
<b>COMPOSITION AND ROLE OF BOARDS OF DIRECTORS</b>				
5. Must boards have independent directors? What percentage?	X		CGC	Compulsory rate is one-third. However, corporate governance regulations only apply to listed companies. Unlisted companies are not required to have independent board members. In 2009, some 60% of companies had one-third independent members on the Board of Directors.
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?		X		As independent Directors comprise of just one-third of the Board, they do not have significant influence.
7. Do independent directors decide what information the board receives from management?	X		CL	Members of Boards (whether are dependent or independent) have rights to information and managers are required to be responsible to supply timely, sufficient and correct information (Article 114).
8. Are the chairman of the board and chief executive officer different persons in the majority of listed companies?	X		CGC	The regulations on corporate governance require a separation between the two positions. If this is not the case, companies must get seek advice in the meetings of shareholders. In 2009, approximately 50% of companies listed with the Stock Exchange Bureau have a separation of chairman and chief executive officer.
9. Are all board members elected annually?		X	CL, CGC	Enterprise Law does not prescribe the elected term of Board members. It only regulates the full term of the Board (not exceeding five years). As a result, board members are re-elected only when Board of Directors finishes its term except in the case when the Board members are dismissed or voluntarily withdraw.

Criteria	Yes	No	Source(s) of Rule	Comments
10. Does the board oversee enforcement of a company code of conduct?	X		CGC	
<b>TRANSPARENCY AND DISCLOSURE OF INFORMATION</b>				
11. Do financial statements comply with International Financial Reporting Standards (IFRS)?	Partly		Accounting Law, Viet Nam Accounting Reporting Standards (VAS)	Financial statements of joint stock companies must comply with VAS. To date, Viet Nam has issued 26 Viet Nameese accounting standards. In essence, these standards are built on the basis of conformity with IFRS, but many of them have not been promulgated. Furthermore, a number of promulgated standards have conflict with IFRS. Viet Nam aims, by 2020, to have the VAS system completely in harmony with international accounting standards.
12. Are the identities of the five largest shareholders disclosed?	X		SL and other law-guiding regulations	
13. Is compensation of company executive officers disclosed?	X		SL, regulation on information disclosure	
14. Are extraordinary corporate events disclosed?	X		CGC, regulation on information disclosure	
15. Are risk factors disclosed in securities offering materials?	X		SL	
16. Are transactions of a company with its insiders disclosed?	X		CL, SL	These transactions must be approved by the Board of Directors or the General Meeting of Shareholders.

*Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory*

# Abbreviations and Acronyms

ABAC	APEC Business Advisory Council
AEPR	APEC Economic Policy Report
CPA	certified professional accountants
CSR	corporate social responsibility
FSAP	Financial Sector Assessment Program
GFC	Global Financial Crisis
IERS	Individual Economy Reports
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOD	Institution of Directors' Association
LAISR	Leaders' Agenda to Implement Structural Reform
OECD	Organization for Economic Cooperation and Development
ROSC	observance of standards and codes
SOEs	state-owned enterprises

## **Australia**

AICD	Australian Institute of Company Directors
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
AWB	Australian Wheat Board
CAC	<i>Commonwealth Authorities and Companies Act 1997</i>
PC	Productivity Commission
RIAA	Responsible Investment Association of Australasia

## **Canada**

CICA	Canadian Institute of Chartered Accountants
CSA	Canadian Securities Administrators
CSF	Chambre de la Sécurité Financière
ICD	Institute of Corporate Directors
IIROC	Investment Industry Regulatory Organization of Canada
MFDA	Mutual Funds Dealers Association
OSC	Ontario Securities Commission
SROs	self-regulatory organizations
SHARE	Shareholder Association for Research and Education
TSX	Toronto Stock Exchange
TSXV	TSX Venture Exchange

## **Chile**

AFPs	Pension Fund Administrators
CORFO	Chile's Economic Development Agency
ESE	Electronic Stock Exchange
FASA	Farmacías Ahumadas S.A.
SBIF	Superintendency of Banks and Financial Institutions
SEP	System of State Enterprises
SP	Superintendency of Pensions
SSE	Santiago Stock Exchange
SVS	Superintendency of Securities and Insurance
VSE	Valparaíso Stock Exchange

**Hong Kong, China**

AIG	American International Group, Inc.
AIs	authorised institutions
CDS	credit default swaps
CFA	Court of Final Appeal
CO	Companies Ordinance (Cap. 32)
CPs	Code Provisions
Fed	Federal Reserve Board
FFTR	US Fed Funds Target Rate
GEM Rules	Growth Enterprise Market of the Stock Exchange of Hong Kong Limited
HKC	Hong Kong, China
HKEx	Hong Kong Exchanges and Clearing Limited
HKICPA	Hong Kong Institute of Certified Public Accountants
HKIoD	Hong Kong Institute of Directors
HKMA	Hong Kong Monetary Authority
LOLR	lender of last resort
MPF	Mandatory Provident Fund
MPFA	Mandatory Provident Fund Schemes Authority
PSI	price sensitive information
QIS	quantitative impact study
RBPs	Recommended Best Practices
SCCLR	Standing Committee on Company Law Reform
SDA	statutory derivative action
SEHK	Stock Exchange of Hong Kong
SFC	Securities and Futures Commission
SFO	Securities and Futures Ordinance (Cap. 571)

**Indonesia**

BI	Bank Indonesia
BoC	board of commissioners
BoD	board of directors
CGCG	Code of Good Corporate Governance
CL	Company Law
COSO	Committee of Sponsoring Organizations of the Treadway Commission
GCG	Good Corporate Governance
IDX	Indonesian Stock Exchange
IICD	Indonesian Institute for Corporate Directorship
IICG	Indonesian Institute of Corporate Governance
IKAI	<i>Ikatan Komite Audit Indonesia</i>
ISICOM	Indonesian Society of Commissioners
KNKCG	<i>Komite Nasional Kebijakan Corporate Governance</i> (National Committee on Corporate Governance Policy)
LKDI	<i>Lembaga Komisaris dan Direktur Indonesia</i>
NCG	National Commission on Governance
RPTs	related party transactions

**Japan**

FSA	Financial Services Agency
FSC	Financial System Council
METI	Ministry of Economy, Trade and Industry

MOJ Ministry of Justice  
TSE Tokyo Stock Exchange

### **Republic of Korea**

KLCA Korea Listed Companies Association  
KOSDAQ Korean Securities Dealers Automated Quotations

### **Malaysia**

AIF Asian Institute of Finance  
AOB Audit Oversight Board  
BNM Bank Negara Malaysia (Central Bank of Malaysia)  
CCM Companies Commission of Malaysia  
CG corporate governance  
CMSA *Capital Market & Services Act 2007*  
FRSIC Financial Reporting Standards Implementation Committee  
FSEC Financial Stability Executive Committee  
GLCs government-linked companies  
GLCT Government-Linked Company Transformation  
IASC International Accounting Standards Committee  
IBBM Institut Bank-Bank Malaysia  
IBFIM Islamic Banking and Finance Institute Malaysia  
ICLIF International Centre for Leadership in Finance  
IPO initial public offerings  
LR Listing Requirements  
MACD Malaysian Alliance of Corporate Directors  
MASB Malaysian Accounting Standards Board  
MCCG Malaysian Code on Corporate Governance  
MIA Malaysian Institute of Accountants  
MII Malaysian Insurance Institute  
MOF Minister of Finance Incorporated  
PCG Putrajaya Committee on GLC High Performance  
PLC public listed companies  
SC Securities Commission  
SIDC Securities Industry Development Corporation  
UUM Universiti Utara Malaysia

### **Mexico**

BMV Bolsa Mexicana de Valores (stock Exchange )  
CEGC *Centro de Excelencia en Gobierno Corporativo* (Center for Excellence in Corporate Governance)  
CNBV *Comision Navional Bancaria y de Valores* (National Banking and Securities Commission)  
FSAP Financial Sector Assessment Program  
IIF Institute of International Finance  
LGSM Company Law  
LMV Securities Market Law  
SHCP *Secretaría de Hacienda y Crédito Público* (Secretariat of Finance and Public Credit)  
WFE World Federation of Exchanges

### **New Zealand**

COMU Crown Ownership Monitoring Unit

FMA	Financial Markets Authority
NEU	National Enforcement Unit
NZX	New Zealand Exchange Limited
ROC	Registrar of Companies
SCI	Statement of Corporate Intent

### **Peru**

CONASEV	National Supervisory Commission for Companies and securities
FONAFE	National Fund for the Financing of State Entrepreneurial Activities
IBCG	Corporate Governance Index
LGS	General Corporation Law
MBA	Masters of Business Administration
RPMV	Public Security Market Registry
SBS	Superintendency of Banking, Insurance and Private Pension Funds Administrators

### **Philippines**

BSP	Bangko Sentral ng Pilipinas
CA	Court of Appeals
CGS	Corporate Governance Scorecard
CHED	Commission on Higher Education
FOCCs	Family-owned corporations
GAAP	Generally Accepted Accounting Principles
GOCCs	Government Owned and Controlled Corporations
IC	Insurance Commission
ICD	Institute of Corporate Directors
PLCs	publicly-listed companies
PSE	Philippine Stock Exchange
SEC	Securities and Exchange Commission
SRC	Securities Regulation Code

### ***Russian Federation***

GDP	Gross Domestic Product
RSFSR	Russian Soviet Federal Socialist Republic

### **Singapore**

ACGC	Audit Committee Guidance Committee
ACRA	Accounting and Corporate Regulatory Authority
AGM	Annual General Meeting
CG	Corporate Governance
Code	Singapore Code of Corporate Governance
CTI	Corporate Transparency Index
FAA	Financial Advisers Act
GIC	Government of Singapore Investment Corporation
MAS	Monetary Authority of Singapore
SFA	Securities and Futures Act
SGX	Singapore Exchange Limited
SID	Singapore Institute of Directors

### **Chinese Taipei**

CGA	Corporate Governance Association
FSC	Financial Supervisory Commission

GTSM	GreTai Securities Market,
MOPS	Market Observation Post System
SFI	Securities and Futures Institute
TSA	Taiwan Securities Association
TWSE	Taiwan Stock Exchange

### **Thailand**

BOT	Bank of Thailand
CG-ROSC	Corporate Governance Report on the Observance of Standards and Codes
DSI	Department of Special Investigation
FAP	Federation of Accounting Professions
FAP	Federation of Accounting Professions
IOD	Thai Institution of Directors' Association
NCGC	National Corporate Governance Committee
OAG	Office of the Attorney General
OIC	Office of Insurance Commission
PCA	Public Limited Companies Act
SEA	<i>Securities and Exchange Act</i>
SEC	Securities and Exchange Commission, Thailand
SEPA	State Enterprise Performance Appraisal
SEPO	State Enterprise Policy Office
SER	State Enterprise Review
SET	Stock Exchange of Thailand
TIA	Thai Investors Association
TLCA	Thai Listed Companies Association
TSI	Thailand Securities Institute

### **United States**

DGCL	Delaware General Corporation Law
GAAP	Generally Accepted Accounting Principles
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
NACD	National Association of Corporate Directors
NYSE	New York Stock Exchange
SEC	US Securities and Exchange Commission
TARP	Troubled Asset Relief Program

### **Viet Nam**

SSC	State Securities Commission
VAS	Viet Nam Accounting Reporting Standards

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