Implementing the White Paper on Corporate Governance in Asia

STOCK-TAKE OF PROGRESS ON PRIORITIES AND RECOMMENDATIONS FOR REFORM

Asian Roundtable on Corporate Governance

October 2006

OECD

Implementing the White Paper on Corporate Governance in Asia

A STOCK-TAKE OF PROGRESS ON IMPLEMENTATION
OF PRIORITIES AND RECOMMENDATIONS
FOR REFORM INCLUDED IN THE 2003 WHITE PAPER
ON CORPORATE GOVERNANCE IN ASIA

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ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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Background to the Report

The Asian Roundtable on Corporate Governance

Objectives

1. The Asian Roundtable on Corporate Governance ("Roundtable") serves as a regional forum for structured policy dialogue on corporate governance. Established in 1999 in response to a G-7 mandate to the OECD and the World Bank to encourage the implementation of the OECD Principles of Corporate Governance (the "OECD Principles"), the Roundtable comprises senior policy-makers, regulators, and representatives from stock exchanges, private-sector bodies, multilateral organisations, and non-governmental institutions.

2. The overall goal of the Roundtable is to assist decision-makers from the private and public sectors in their efforts to improve corporate governance in the region. This will be achieved by providing a forum for the discussion of best practice and national experiences in a multilateral setting.

3. The Roundtable's objectives can be summarised as follows:

   - To promote better governance in the Asian region
   - To improve the understanding of corporate governance and assist in developing policy responses
   - To promote an ongoing dialogue between the private and public sectors
   - To monitor and evaluate developments in the region
   - To identify needs for technical assistance
   - To inform the international community about national and regional reform initiatives

Constituencies

4. The participating Asian economies include Bangladesh, China, Hong Kong China, India, Indonesia, Korea, Malaysia, Pakistan, the Philippines, Singapore, Chinese Taipei, Thailand and Vietnam. Representatives from Brunei Darussalam and Sri Lanka have also contributed to the Roundtable on an *ad hoc* basis.

5. The Roundtable is attended on a regular basis by selected private sector representatives, investors, corporations and other organisations with a special interest in corporate governance. Regional professional associations, such as accounting associations and institutes of directors are also participating on a regular basis to share their expertise.

6. In addition, apart from the OECD and the World Bank / IFC, several international organisations actively contribute on a regular basis to the work of the Roundtable, in particular the Asian Development Bank and the Asian Development Bank Institute, the Bank for International Settlements and the Global Corporate Governance Forum. Furthermore several OECD member countries have participated in the Roundtable meetings, with representatives from Australia, Austria, Czech Republic, Canada, Denmark, France, Germany, Hungary, Italy, Japan, Korea, Mexico, the Netherlands, New Zealand, Spain, Sweden, the United Kingdom and the United States of America.

Activities

7. Since March 1999 the Roundtable has formally met seven times to discuss improving corporate governance in the Asian region. The Roundtables were organised in Korea, Hong Kong China, Singapore, India, Kuala Lumpur, again Korea, and Indonesia. Using the OECD Principles as the conceptual framework, the Roundtables examined a range of subjects, from boards of directors to minority-shareholder protection, disclosure and transparency issues, as well as the issue of implementation and enforcement.

8. The Roundtable in its in November 2004 in Seoul, Korea, commissioned the set up of task forces dedicated to specific priority topics in order for them to draft so-called policy briefs providing for concrete policy recommendations on the particular topic assigned to the task force. As a result two initiatives have been launched, the *Task Force on Corporate Governance of Banks in Asia* and the *Network on Corporate Governance of State Owned Enterprises in Asia*. The two groups reported back on their activities to the Roundtable in its meeting in Bali, Indonesia,

in September 2005. The Task Force on Corporate Governance of Banks in Asia launched its *Policy Brief on Corporate Governance of Banks in Asia* in June 2006 in a meeting in Hong Kong China organised in co-operation with the Bank for International Settlements / Financial Stability Institute.

9. More recently under the auspices of the Roundtable country focused meetings have been organised in Vietnam (December 2004), Bangladesh August 2005), Indonesia (September 2005) and India (March 2006). These demand driven meetings serve to the need in these countries for more in depth discussions on country specific issues among local policymakers and stakeholders with the OECD and experts from OECD countries.

Achievements

10. The Roundtable has successfully created a network of policy-makers, regulators, business representatives and academics in the Asian region that annually meet to further the issue of corporate governance. In fact, it was the Roundtable that institutionalised corporate governance as a priority on the agenda of policy makers in the participating economies.

11. The most visible achievement of the Roundtable has been the issue of the Asian White Paper on Corporate Governance (the 'White Paper') in 2003. As a result of its policy meetings the Roundtable has, in the period 1999 - 2003, identified key areas for improvement and set out concrete guidance on how to improve corporate governance practices in Asia. These insights have been assembled in the White Paper, which describes the most urgent areas for attention and proposes ways to respond to these shortcomings. Its main use until now has been to raise awareness and setting the priorities and direction for efforts to improve the corporate governance framework at the national level. In conclusion the White Paper sets out six priorities together with 36 recommendations for reform to be considered and implemented by national policy makers.

12. The conclusions drawn in the White Paper have also served as input for the review of the 1999 version of the OECD Principles, which resulted in the issue of the amended OECD Principles in May 2004. Moreover, Roundtable participants contributed actively in the consultation meeting with non-member countries organised by the OECD in the process that cumulated in the *2005 OECD Guidelines on Corporate Governance of State-owned Enterprises*.

13. Background documentation for the Roundtable discussions has been made public and disseminated. Each of the consecutive Roundtable meetings

resulted in the gathering and dissemination of information on ownership structures, corporate governance practices, regulatory provisions and enforcement mechanisms in selected Asian countries. These and further information have been disseminated through the OECD website (http://www.oecd.org/daf/corporate-affairs) dedicated exclusively to the Roundtable. The website collects papers presented at meetings and other literature on corporate governance and provides links to other sources within the region working on the topic. The website provides for a substantive source of information on corporate governance developments in Asia.

Executive Summary

14. To gain an overview of corporate governance reform in Asia over the past three years, this report summarises legal and regulatory policy reforms in the following 13 Asian economies: Bangladesh, China, Hong Kong China, India, Indonesia, Korea, Malaysia, Pakistan, Philippines, Singapore, Chinese Taipei, Thailand and Vietnam. In 2003 the Roundtable issued the White Paper. The White Paper provided six priorities and 36 recommendations for reform. This report assesses the progress on reform of the six priorities.

Raising awareness

15. ***Awareness in the region of the importance of good governance has increased considerably***. However, in order to promote more effectively awareness in corporate governance, co-operation between the public and private sectors is of the essence. Solid institutionalised examples of this include the establishment in India, Indonesia, Pakistan, Singapore and Thailand of national committees on corporate governance (Malaysia already had such a platform since 1998). To further develop public awareness about corporate governance, policymakers, the private sector and academics should also engage the media.

16. ***Asian policymakers should make use of public consultation when drafting corporate governance regulation and legislation.*** To underline the importance of public consultation, policymakers should also consider making all comments publicly available and justify the rationale for the final decision made. The public debate, and thus awareness, on corporate governance in the Roundtable economies would benefit from policymakers being transparent about the approach followed regarding reforms, as well as the rationale behind them. In particular the adoption of corporate governance codes for listed companies has proven to be a good vehicle for private sector consultation.

17. ***Continuing director training should be encouraged and promoted.*** In some economies, e.g. Malaysia and Thailand, education programmes have

become a mandatory prerequisite for directors of listed companies. This is the typical example where public and private initiatives converge. To ensure the development of proper training and educational programmes, an institutional framework is useful. Such institutional framework ideally includes both public and private sector players. To that effect in several Asian economies national institutes of directors have been set up. Some of them intend to further co-operate and therefore have set up an alliance, called IDEA.Net, the Institute of Directors East Asia Network with as its common goal the promotion of higher standards of corporate governance. In particular in the field of best practices the different national institutes may learn from each other.

Effective enforcement

18. ***Effective enforcement starts with the need for both national and local authorities, as well as enforcement entities, to commit to the rule of law.*** With respect to the enforcement entities their mandate and responsibilities should be clear and transparent. Often opaque regulatory frameworks with many constituencies each having certain powers may impede the quality and strength of effective implementation and enforcement of corporate governance legislation and regulation. In several Asian economies, surveillance, investigation and prosecution of corporate governance violations often involve the overlapping jurisdictions of different regulators.

19. ***The enforcement capability of regulators needs to be strengthened.*** Much focus has been on regulatory capacity building, for example in China, Hong Kong China, India, Malaysia, Singapore, Chinese Taipei and Thailand. However, simultaneously, or prior thereto, legislators should clarify the accountability of regulatory agencies. A transparent and functional division of responsibilities between regulators, stock exchanges and other self-regulating organisations needs to be implemented, and an effective system of co-operation between them should be developed.

20. ***Political interference by the state should be prevented.*** Therefore the legislator should first clearly define the objectives of the legislation and regulation imposed, as well as the role of the regulators on the one hand and the market players on the other hand. This requires political will and commitment. Due to political interference, the implementation of a balanced enforcement framework may also be problematic. Competition will be affected if some market players have better conditions than others due to uneven enforcement of corporate governance regulation. This can be a particular a problem in countries with many state owned enterprises (e.g. China, Vietnam).

21. One of the instruments used for implementing the corporate governance agenda is the use of voluntary or mandatory codes, principles, guidelines or best practices. Since January 2003 new codes have been adopted in Bangladesh, Hong Kong China, Indonesia, Singapore and Korea, while the codes in Pakistan, Chinese Taipei and Thailand were all adopted in 2002. The success of these codes, in terms of their impact, depends amongst others on their often unclear status. When codes and principles are used as a national standard or as an explicit substitute for legal or regulatory provisions, their status in terms of coverage, implementation and enforceability should be clearly specified by policymakers.

22. ***In most Asian jurisdictions, the lack of knowledge and experience within the judiciary still forms a serious constraint for solving corporate governance related disputes***, as well as for providing exit options for shareholders and creditors either via liquidation or bankruptcy proceedings. Therefore there remains a clear need to further develop the capacity to adjudicate corporate governance related disputes, either through specialised courts or alternative dispute resolution.

23. One explanation for the lack of knowledge and experience within the judiciary on corporate governance related disputes, is the practice of legal transplant. In some of the Roundtable economies, the legal framework consists of different elements transplanted from different legal cultures. Although incorporating best practices from around the world at national level sounds logical, in the long run effective implementation and enforcement thereof will prove difficult, and thus costly, unless there is a coherent strategy addressing each of the specific needs for successful implementation.

Accounting and auditing

24. ***Accounting and auditing standards have been introduced, amended or radically changed in the Asian Roundtable economies since publication of the White Paper.*** While changing and updating the policy framework in this field, benchmarking with international standards and best practices has been the rule. Often undertaken by new national standards setters or oversight bodies, e.g. in India, Malaysia, Singapore, Thailand, or currently under consideration, i.e. Bangladesh, convergence with international standards and practices for accounting, audit and non-financial disclosure indeed seems on its way; however, *full* convergence is in most cases not realised yet.

25. To close the respective remaining gaps between nationally applied and internationally agreed accounting standards, the establishment of

independent national standard-setting boards for formulation, adoption and oversight of national accounting standards is a priority. Likewise remaining inconsistencies between nationally applied and internationally agreed auditing standards should be resolved.

26. ***In several Asian economies an obstacle to progress in the short term is the institutional framework.*** While the regulatory framework has improved in most Roundtable economies the necessary institutions to properly interpret, translate and implement the international standards are sometimes lacking the necessary resources.

27. Overlap or "overkill" by specific regulators each overseeing a particular part of compliance may in practice cause unnecessary costs: for the regulators involved, since the regulatory supervision function regarding the same issue is duplicated; and compliance costs for the reviewed companies arise twice.

28. ***Audit committees for listed companies should become mandatory***. Requirements about qualifications and experience of audit committee members should also be clearly formulated, imposed and implemented by policymakers. Moreover, the quality of accountants and auditors, both internal and external, should be ensured and sustained by imposing both (permanent) professional training programmes and formal accreditation. Independence being one of the most important qualifications, periodical rotation of auditors (e.g. every five years) should become the mandatory standard for listed companies.

29. Legislation regarding consolidation of accounts of group companies should be considered. This is in particular important in Asia where the issue of non-transparent related party transactions within groups of companies remains a problem. Moreover, to improve transparency in general, the disclosure requirements on non-financial information, including on corporate governance matters, to be disclosed in annual reports of listed companies, should be strengthened.

30. ***The issue of how to prevent abusive related party transactions by insiders to the detriment of (other) shareholders and stakeholders needs to be addressed by policymakers in almost all Roundtable economies.*** This issue in practice has proven to be challenging. Different elements play a role, including, but not limited to, in particular the role of audit committees, and more in general the role of the board and senior management. Moreover as pointed out elsewhere in this Executive Summary, as well as in the Executive Summary of the *Policy Brief on Corporate Governance of Banks in Asia* (Annex B to this report), disclosure, independent directors, fiduciary duties of board members and

directors, ownership structures and consolidation of groups of companies need to be taken into account.

31. ***A 'box-ticking' mentality may prove a serious obstacle for sustainable improvement of a proper corporate governance framework in Asia.*** Accounting and auditing of listed companies are typically vulnerable to becoming box ticking exercises of the formally required steps from the rule book rather than complying with the spirit of, and rationale behind, the internationally adopted standards and practices in this field. This concern applies more in general to the challenge of proper implementation and enforcement of corporate governance legislation and regulation in the Roundtable economies.

32. There is a genuine need in Roundtable economies for independent and objective review of self-regulatory bodies in charge of quality assurance and permanent education of their members. Often audit firms are associated in a professional body which also supervises the individual auditors as well as their firms. Potential conflicts of interests are obvious.

Boards and directors

33. ***There has been a clear trend in the Roundtable economies of introducing independent directors in boards of listed companies.*** Recent research (April 2005) by the Asian Corporate Governance Association shows that now in each of China, Hong Kong China, India, Indonesia, Korea, Malaysia, Philippines, Singapore, Chinese Taipei (albeit to a limited extent) and Thailand independent directors are required on boards of listed companies. The independence of formally "independent" directors is sometimes questionable. This may be due to ambiguous definitions in regulation regarding independent directors. Further thought needs to be given by policymakers to the issue of whether in practice independent directors indeed have an impact in terms of proper corporate governance of listed Asian companies.

34. ***Defining the fiduciary duties of directors and board members in the company law should be considered***, in particular in view of the increasingly important role of independent directors in Asian economies. Also in view of the practice common in Asian groups of companies of appointing directors and board members to the different group companies which makes compliance with fiduciary duties by such directors difficult, if not impossible.

35. The number of board memberships should be limited to ensure that individual directors indeed devote the necessary time to boards in which they have a seat. This will also enhance compliance by individual

directors and board members with best practices formulated in corporate governance codes. Asian policymakers should consider developing incentives to promote and ensure compliance. Strengthening civil enforcement options for investors by introducing legislation to facilitate derivative suits against individual directors for breach of their fiduciary duties may be one of the options.

36. Board meeting attendance in Asian companies, which should be one of the first priorities for any board member, appears to be often low. Moreover, the large size of boards in practice makes efficient decision making processes difficult. Asian policymakers should consider how to improve these inefficiencies in the corporate governance framework.

Ownership structures and shareholders' rights

37. ***In respect of proper protection of the interests of non-controlling shareholders promising steps have been taken in several Roundtable economies, in particular through the introduction of new policies on three topics, i.e. class actions, independent directors and proxy voting.*** Each of China, Hong Kong China, Korea, Malaysia and Chinese Taipei have introduced legislation to promote civil enforcement through different forms of class actions and in some cases derivative suits.

38. Policymakers in China, Malaysia, Pakistan and the Philippines have been focusing on how to streamline the voting process and to ensure that all shareholders can effectively make use of their voting rights; proxy voting mechanisms have been put in place and will have to prove themselves in the years to come.

39. ***Opaque ownership structures for Asian groups of companies restrict transparency often to the benefit of one or a few controlling (minority) shareholder and thus to the detriment of non-controlling shareholders.*** The need for policy reforms in order to make such opaque ownership structures comply with good corporate governance standards seems obvious but remains often difficult to achieve due to political considerations. In general, ownership structures in Asian listed companies whereby the controlling shareholder is a family, examples thereof can be found in China, Indonesia, Hong Kong China and Korea, or the state, in particular in China and Vietnam, often create problems for non-controlling shareholders to properly effectuate their shareholders rights.

40. Considering the important role of controlling shareholders in the Asian economies, introducing incentives in legislation and regulation for controlling shareholders to adhere to good corporate governance practices is important. In particular in the economies with huge, often family

owned, groups of companies with one or more listed groups of companies involved, and in those economies where the state still plays a dominant role as shareholder in listed companies.

41. Mandatory disclosure of underlying shareholdings by directors and board members and / or holding companies will increase transparency. Similar to that, mandatory disclosure of interlocking shareholdings (via cross shareholdings and pyramid structures) will increase in particular the corporate governance levels of groups of companies.

42. Existing legislation and regulation may restrict the monitoring role of non-controlling shareholders and their options of exercising control. Because of weak incentives shareholder activism is lacking, even by institutional investors. In connection therewith the introduction of well functioning and effective insider trading legislation to cover both transactions among insiders and trading in the company's shares by board members having non public knowledge or information, should be a priority in those Roundtable economies that have not yet done so.

Corporate governance of banks

43. ***All Roundtable economies have indeed made progress to improve the policy framework for corporate governance of banks.*** Modern doctrine on financial supervision relies on three factors for bank regulation: (i) the bank's internal governance; (ii) surveillance by the market of the banks, and (iii) official banking supervision. Each of these factors has an impact on corporate governance of banks. Most of the efforts in Asian economies have been focused on the banks' internal governance. And in some Roundtable economies, for example in China and the Philippines, also efforts have been undertaken to strengthen the role of the banking regulator.

44. Reflecting the relatively short history of economic development in the region, many Asian jurisdictions still do not have in place sufficient institutional infrastructure (e.g. sufficient resources, experience, focus, and know-how) necessary for effective enforcement of the corporate governance policy framework. Asian banks play a dominant role in regional finance due to the yet immature capital markets, and Asian policy makers should be aware that sound corporate governance of banks cannot be developed effectively without tackling institutional constraints and weaknesses.

45. Considering the importance of corporate governance of banks, the Roundtable established the Task Force on Corporate Governance of Banks in Asia. The Task Force has drafted the *Policy Brief on Corporate*

Governance of Banks in Asia, which provides policy recommendations for improving corporate governance of banks in Asia; it also refers to the challenges and obstacles to achieve such improvement. The Executive Summary of the *Policy Brief on Corporate Governance of Banks in Asia* is attached as Annex to this report. (Full text version is available at http://www.oecd.org/dataoecd/48/55/37180641.pdf)

Introduction

46. The stock-take exercise as called for by the Asian Roundtable on Corporate Governance (Roundtable) in its 2003 White Paper on Corporate Governance in Asia (White Paper; see paragraph #2 of the White Paper), has given policy makers, practitioners, academics and other stakeholders the opportunity to express their views on developments over the past three years on the six priority issues and 36 recommendations formulated in the White Paper.

47. In order to assess the progress of implementation of the proposed priorities and recommendations for reform since the publication of the White Paper, the stock-taking of developments in Asia has been largely based on responses to a questionnaire as well as research, annual reports and websites, each provided by policymakers, academics, stock exchanges, practitioners and NGOs. In the period between May 2005 and March 2006, 25 respondents from 13 participating Asian economies in the Roundtable provided their responses to the questionnaire.

48. This report summarises the main conclusions derived from the responses to the Questionnaire as well as further literature. As reference date we have used 1 January 2003 and the report covers policy developments in the period after this date up to 31 March 2005. The report focuses on *policy developments*. In respect of each Priority a short introduction summarises the general *progress since 2003*; thereafter *key developments* in the relevant economies are described, followed by a shortlist of *obstacles to progress*, and recommendations for *issues for further improvement*. The last two topics are obviously interrelated since today's obstacles to progress may be tomorrow's issues for further improvement.

49. The information provided by respondents to the questionnaire has not been used, and is not intended to be used, to rank or rate countries, but merely to support the Roundtable's focus on implementation and enforcement issues and to establish the Roundtable's future work programme. This stock-taking report will enable Asian policymakers, Roundtable participants and the public to assess progress and to identify remaining challenges and obstacles. The identification of remaining

challenges in corporate governance may be in particular relevant to establish the future agenda of the Roundtable.

50. As stated above it should be noted that this report is a follow-up on the White Paper and not directly on the OECD Principles, although the OECD Principles remain the key reference for the Roundtable's ongoing work. The latter have been updated in May 2004, i.e. after publication of the White Paper. The new version of the OECD Principles contains a new chapter which focuses on implementation and enforcement.

51. It is important to note that regarding some Roundtable economies there is more to be mentioned in terms of progress than about others. This obviously does not mean that those Roundtable economies which are not (extensively) discussed in each of the sections covering the six Priorities, are making no progress. Often this is proof of the fact that the suggested priorities and recommendations for policy reform mentioned in the White Paper had already been (partly) implemented within the relevant Roundtable economy prior to the chosen reference date of 1 January 2003. Consequently the level of progress in such economies may indeed be less compared to those economies more extensively covered in this report; but the quality of the corporate governance policy framework may well be better at this stage.

52. The following chapter includes the main results of the stock-taking exercise. This chapter focuses on country progress in respect of each of the six priority areas for policy reform identified in the White Paper. In order to frame the scope of the stock-take exercise this stock-take report does not cover each of the 36 recommendations at country level specifically, although they have been considered (and are referred to) where relevant.

Thematic Stock Take of Policy Developments and Progress on Corporate Governance in Asia

Six Priorities for Reform

53. This chapter follows the order of the six priorities formulated in the White Paper (see Box 1).

Box 1. White Paper Priorities for Reform

Priority 1: Public- and private-sector institutions should continue to raise awareness among companies, directors, shareholders and other interested parties of the value of good corporate governance.

Priority 2: All jurisdictions should strive for effective implementation and enforcement of corporate-governance laws and regulations.

Priority 3: Asian Roundtable Countries should work towards full convergence with international standards and practices for accounting, audit and non-financial disclosure. Where, for the time being, full convergence is not possible, divergences from international standards and practices (and the reasons for these divergences) should be disclosed by standards setters; company financial statements should repeat or reference these disclosures where relevant to specific items.

Priority 4: Boards of directors must improve their participation in strategic planning, monitoring of internal control systems and independent review of transactions involving managers, controlling shareholders and other insiders.

Priority 5: The legal and regulatory framework should ensure that non-controlling shareholders are protected from exploitation by insiders and controlling shareholders.

Priority 6: Governments should intensify their efforts to improve the regulation and corporate governance of banks.

Source : White Paper on Corporate Governance in Asia (OECD 2003)

1. *Priority 1*

Raising awareness about the value of good corporate governance

1.1. Progress since 2003

54. As set out in the White Paper, raising awareness means to a large extent convincing shareholders and other stakeholders that corporate governance is in their self-interest. Awareness in the region of the importance of good governance has increased considerably. Experience has shown that both the public and the private sector have contributed.

55. Many initiatives to improve awareness of good corporate governance have been undertaken. Obviously they vary widely, among countries, but also within countries among the different constituencies involved. Awareness raising about the values of good corporate governance is a rather broad concept. The relevant constituencies that have pursued this priority have chosen themselves the tools and means to be used. This explains the wide variety of initiatives undertaken in Asia in this field over the past few years. Initiatives include information and education programmes for directors, investors, employees and other stakeholders, but also politicians and students, by both public and private sector institutions. Apart from this also the role of the press has emerged.

56. In addition seeking market views by policymakers through public consultation has well functioned as a trigger for national debate. In particular the adoption of codes of corporate governance for listed companies has proven to be a proper momentum for private sector consultation. A summary of principles, codes and guidelines currently adopted in the Roundtable economies is included in Box 4.

1.2 Key developments

57. Although many initiatives were already launched prior to the issue of the White Paper in 2003 some substantive subsequent developments at country level are to be mentioned.

58. In order to raise awareness ensuring the development of proper training and educational programmes an institutional framework may help. Such institutional framework ideally includes both public and private sector players. To that effect in several Asian economies institutes of directors have been set up. Some of them have been co-operating in developing a Corporate Governance Scorecard for Listed Companies (Thailand, Hong Kong China,

China, Philippines and Indonesia). The scorecard basically is a corporate governance evaluation instrument designed to assess a range of corporate governance issues such as the responsibility of board of directors, shareholders' rights, disclosure and transparency, shareholding structure and shareholder protection. The methodology used for the scorecard referred to herein is based on the OECD Principles of Corporate Governance.

59. Similar to the Corporate Governance Scorecard for Listed Companies, the Philippines institute of directors is currently working on a corporate governance score card for state-owned enterprises. The methodology for this specific scorecard is based on the OECD Guidelines on Corporate Governance of State-owned Enterprises.

60. In addition national institutes of directors intend to further co-operate by setting up an alliance, called IDEA.Net (Institute of Directors East Asia Network (see Box 2. for an overview of its members)) with as its common goal the promotion of higher standards of corporate governance. In particular in the field of best practices the different institutes may learn from each other. The need for further effectively developing an alliance such as IDEA.Net in promoting regional awareness on corporate governance among directors and board members is also underlined by the recent establishment of a European equivalent, the European Confederation of Directors Associations. IDEA.Net usually has its annual meeting back-to-back with the annual Roundtable meeting.

61. As described above the private sector is mainly involved in developing training programmes for directors and management. In some economies (e.g. Malaysia) these education programmes have become a mandatory prerequisite for directors of listed companies. This is the typical example where public and private initiatives converge.

Box 2. IDEA.Net

China - Chinese Center of Corporate Governance
Hong Kong China - Hong Kong Institute of Directors
Indonesia - Indonesian Institute for Corporate Directorship
Korea - Asian Institute of Corporate Governance
Malaysia - Malaysian Institute of Corporate Governance
Philippines - Philippines Institute of Corporate Directors
Singapore - Singapore Institute of Directors
Chinese Taipei
Thailand - Thai Institute of Directors Association

Source : IDEA.Net (2005)

62. In **Bangladesh** both the Bangladesh Central Bank and the Securities and Exchange Commission (SEC) supported the private initiative by the Bangladesh Enterprise Institute (BEI) to draft a Code of Corporate Governance for Bangladesh which was issued in March 2004. BEI also organises training on corporate governance implementation for company directors. Furthermore the Center for Corporate Governance and Finance Studies of Dhaka University together with the Stock Exchange and in co-operation with the Asia Foundation and the OECD organised the first International Conference on Corporate Governance in Bangladesh in July 2005; the conference, inaugurated by the President of Bangladesh, attracted a diverse group of participants, including business representatives and politicians, and made headlines in the national press. Similarly workshops on corporate governance in Bangladesh were organised in 2003 and 2004 by BEI and also the SEC in co-operation with the Asian Development Bank. The role of the press in promoting awareness may increase now that the government is contemplating to amend the Defamation Law.

63. The process that lead to the adoption by the **China** National People's Congress on 27 October 2005 of both the Securities Law and the Company Law (both laws became effective on 1 January 2006) would have been an opportunity for the legislator to hear the views of market participants on each of the draft laws; although the legislator did consult with many related government departments and also with some market institutions such as the stock exchanges, the drafting process has been mostly confidential. On the other hand, to improve the understanding of corporate governance and fiduciary duties among directors and officers, the China Securities Regulatory Commission (CSRC) together with some prominent universities, runs monthly training program for Chinese directors, including courses for independent directors. In the past four years, CSRC has trained more than 10,000 directors and officers of listed companies. Also the Shanghai Stock Exchange (SSE) Research Centre in 2003 for the first time published its Corporate Governance Report setting out concrete policy recommendations; input to the report was generated by the first annual Policy Dialogue on Corporate Governance in China, organised by the SSE in co-operation with the DRC / Enterprise Research Institute and the OECD (in 2004 in Shanghai and subsequently in 2005 in Beijing). Furthermore, to highlight the importance of corporate governance the CSRC has embarked on the reform of the current complicated split share structure in place in listed companies. Finally, different universities have set up dedicated corporate governance research groups.

64. After a prior public consultation process, the Stock Exchange of **Hong Kong China**, revised the Listing Rules to introduce the Code on Corporate Governance Practices and requirements in relation to the Corporate Governance Report. The revised rules became effective for accounting periods commencing on or after 1 January 2005 (with certain exceptions which took effect for accounting periods commencing on or after 1 July 2005). Listed companies are now required to prepare a Corporate Governance Report, to be included in their annual report. Both the Code and the reporting requirements have improved awareness by companies and their directors of the importance of corporate governance.

65. The **India** Ministry of Company Affairs in early 2004 set up the National Foundation for Corporate Governance (NFCG), in which also the Confederation of Indian Industry, the Indian Chartered Accountants Institute and the Institute of Company Secretaries of India participate. The main objective of NFCG is is to create awareness on the importance of implementing good corporate governance practices both at the level of individual corporations and for the economy as a whole. The foundation aims to provide a platform for quality discussions and debates amongst academicians, policy makers, professionals and corporate leaders through workshops, conferences, meetings and seminars. Apart from this most significant initiative on awareness raising a number of other initiatives have been undertaken aimed at raising awareness among stakeholders and interested parties on the benefits of good corporate governance. These include information and education programmes by regulators, industry associations, professional bodies, private training and coaching institutes, publications and journals besides investor bodies. The Indian press and media continues to perform an important role in keeping the discussion on benefits of education and training at centre stage of the debate on corporate governance.

66. In **Indonesia** a new board of the National Committee for Corporate Governance (NCCG, a council in which various representatives from public and private sector co-operate) has been appointed in 2005 which is supposed to amend the 2001 version of the Indonesia Code for Good Corporate Governance. In January 2004 the NCCG issued the Indonesian Banking Sector Code which aims to improve corporate governance of banks. A private initiative concerns the Forum for Corporate Governance in Indonesia (established in 2000) in which private sector companies and professional associations co-operate to promote and to foster the implementation of good corporate governance in Indonesian companies, amongst others by using the “Corporate Governance Self Assessment Checklist” it developed. The Forum’s activities are intended to complement the NCCG’s activities. Another relevant initiative concerns the issue of the

Corporate Governance Perception Index 2004 Report by the Indonesian Institute for Corporate Governance in April 2005; it is the fourth rating research since 2001 and it focuses on implementation of good corporate governance. Furthermore, the Indonesian Chamber of Commerce and Industry (KADIN) set up a Good Corporate Governance Committee which amongst others functions as a promoter of the importance of good corporate governance implementation. The initiative by the securities regulator BAPEPAM, the professional accountants associations and various other associations to award every year the best corporate governance reporting in annual reports also serves the awareness raising.

67. The **Malaysia** Stock Exchange in July 2003 extended its initial Mandatory Accreditation Programme (which was initiated in 2001) to the compulsory Continuing Education Programme. This CEP created greater awareness on the importance of continuing training and skill enhancements for directors and promoted a culture of continuous learning and training. Against this background, with effect from January of 2005, the onus for determining the training needs of directors was placed on the board of directors of listed companies. Boards now have the responsibility of regularly evaluating and determining the specific and continuous training needs of their own directors to enable them to discharge their duties more effectively. Listed companies must now also disclose in their annual reports the type of training attended by their directors for the financial year and the reasons for any non-attendance of training. The Securities Industry Development Centre (SIDC) is the education and training arm of the Securities Commission and undertakes a crucial role in enhancing the skills and professionalism of market participants. SIDC conducts various programmes to educate companies and the public on a wide variety of topic which includes, inter alia, appreciation and awareness of the value and uses of full, accurate and timely disclosure. In addition, the exchange and organisations like Malaysia Institute of Accountants (MIA), Malaysian Institute of Chartered Secretaries and Administrators (MAICSA), Malaysian Institute of Certified Public Accountants (MICPA) and ACCA are also conducting awareness and continuous education programmes for a wide range of topics which include the importance of disclosure to the market.

68. In 2005 the Securities and Exchange Commission of **Pakistan** (SECP) set up the Pakistan Institute of Corporate Governance to provide an independent forum for creating awareness, dialogue, education, training, research and professional development of organizations. Furthermore the SECP and the International Finance Corporation, the private sector arm of the World Bank Group, in August 2005 entered into a partnership promote and support corporate governance reforms in Pakistan. The

programme aims, through the Pakistan Institute of Corporate Governance, to (i) set up training and certificate programs on corporate governance for company directors, managers, and secretaries; (ii) build capacity for research and development to conduct surveys, issue publications, and produce best practice manuals; (iii) develop and provide consulting and advisory services on corporate governance to Pakistan's banks and corporations; (iv) raise awareness of corporate governance practices via conferences, seminars, and roundtables; and (v) to provide policy advice to the government on legal and regulatory reforms relating to corporate governance. Earlier on the SEC set up a project with UNDP ('SEC UNDP') which aimed at promoting good corporate governance practices in both the public and private sector companies by enhancing the capacity of the SEC and development of stable corporate governance framework. The project resulted in the establishment of Corporate Governance Cell which promoted research and produced new resource material through it (Project Report, SEC UNDP Project on Corporate Governance 2003). The research material included briefs focusing on the role of non executive directors, separating the roles of the chairman and chief executive, significance of audit committees, and internal control systems. In addition, the project also organized training programs for directors and management of listed companies in order to implement the Code of Corporate Governance introduced in 2002.

In addition to the preceding initiatives, consultation is also being increasingly adopted as a strategy for creating awareness by identifying issues confronting the corporate sector. The SECP has recently sought comments on the Draft Corporate Scorecard, and User Guide for the Scorecard. It has organised many conferences, seminars, and road shows in order create awareness about the value of good corporate governance and to seek the comments and suggestions in this regard. The SECP has also collaborated with the business school in Lahore for organising two national conferences on corporate governance in Pakistan (2004). Also the SECP has prepared a manual on corporate governance which explains the Code and covers key elements of corporate governance mechanisms (Manual of Corporate Governance 2005). This manual is a reference document for companies, their officers, directors or auditors for complying with the provisions of applicable laws and regulations. The manual amongst others defines corporate governance, underpins the role of management, identifies the key stakeholders and also sheds light on shareholder activism. In addition, it also explains what directors are supposed to know in order to scrutinize the financial statements for greater transparency and accountability.

The 2002 Code of Corporate Governance calls upon the listed companies to organize training courses for enhancing the capacity of its staff about their duties and responsibilities. A recent study shows that more than 93% companies have started organizing such courses for creating awareness and the training of its staff, employees and management (Rasul Baksh Rais, and Saeed, Asif 2005). However there has only been a limited number of courses organised due amongst others high costs incurred by the organization. In a study conducted recently with the sample size of 70 listed companies, it has been found that 75% of the sample companies have organized less than 5 courses for such purpose, 14% have organized more than 5, and only 10% have organized more than 10.

69. The Corporate Governance Association, set up in 2002, is the key institute for promotion of corporate governance, together with the Financial Institutions and Capital Market Reform Working Group, both set up by the **Chinese Taipei** government. To further develop corporate governance policy on 12 November 2003 the government adopted the plan "Accountability for Companies in Chinese Taipei: Policy Agenda and Action Plan to Strengthen Corporate Governance" which includes measures to strengthen accountability, transparency and disclosure, empower shareholders and improve board structure and performance. The Council for Economic Planning and Development is responsible for the agenda. Furthermore, to improve the effectiveness of directors and supervisory directors, the newly (2004) established Financial Supervisory Commission (FSC) appointed the Securities and Finance Institute (SFI) to provide continued training courses for all directors and supervisory directors. The SFI provides practical training courses in the field of company law, finance and accounting. In addition in 2004 the SFI convened two meetings of the Corporate Governance Implementation Taskforce: (i) Responsibilities of Internal Oversight and Accounting in Strengthening Corporate Governance, and (ii) Carrying out Corporate Governance for the Protection of Investor Rights. Also, after being commissioned thereto by the Taiwan Stock Exchange and the Gre-Tai Securities Exchange, the SFI planned and established the 'Information Transparency and Disclosure Ranking System' to improve corporate information disclosure and transparency. A review of all corporate public announcements is conducted once per year and then analyzed and ranked. Results were released in May 2004 and ranked in terms of transparency and information disclosure. In the first year, 611 TSE listed and 308 Gre-Tai listed companies were reviewed and ranked.

70. In **Thailand** the SEC introduced a "Director's Handbook" to serve as a working manual; it explains related laws and regulations in plain language along with clear instructions and examples for directors to follow. It

covers (1) the role and responsibilities of directors, (2) guidelines for directors to properly perform their fiduciary duties, and (3) principles of shareholders' rights and guidelines for conducting a shareholders' meeting. Moreover, after the establishment of the National Corporate Governance Committee (chaired by the Prime Minister) in 2002, the Thai government proclaimed 2002 as the "Year of Good Governance". A private sector initiative by the Thai Institute of Directors Association has led to the annual publication of the "Corporate Governance Report of Thai Listed Companies" which explicitly aims to increase awareness and encourage adoption of best practices for corporate governance in Thailand and which benchmarks listed firms against the OECD Principles on Corporate Governance. Furthermore, subsidies are offered by the government to directors that take part in workshops held by the Institute of Directors of Thailand. The responsible authorities use a "reward and punishment" approach to provide incentives to comply with good corporate governance practice. Awards have been given to a number of companies with sound corporate governance systems. On the other hand, companies with poor corporate governance practices will face more stringent monitoring by the Stock Exchange of Thailand and the SEC (through two Steering Committees, one dealing with Director Discipline, and the other with Accounting and Governance).

71. That there is a strong need for raising awareness on corporate governance in **Vietnam** is underlined by the fact that the Vietnamese language equivalent of "corporate governance" (i.e. *quan tri cong ty*) itself is a confusing term because of which "governance" is sometimes wrongfully understood to be the same as "management". In developing awareness raising programmes, Vietnam often co-operates with donors (countries, NGOs), including:

- The "Support to Industry Restructuring & Enterprise Restructuring"(SIRER), supported by the Danish development agency DANIDA, which aims to develop corporate governance awareness through directors training in the for Vietnam important fisheries industry
- The World Bank programme (ended 31 August 2005) to support the Academy of Finance and the State Securities Commission on enhancing corporate governance within (listed) enterprises and newly equitised state owned enterprises (SOEs)
- The Ministry of Finance together with IFC and the OECD organised a corporate governance awareness raising conference in December 2004, titled "Why corporate governance is important for Vietnam", attended by more than 300 participants

An important development raising awareness about the relevance of corporate governance has been the adoption process of the new Unified Enterprise Law (UEL[1]), approved by the National Assembly of Vietnam on 29 November 2005 and coming into force as of 1 July 2006. The UEL aims to provide common provisions for different kinds of businesses and a unique mechanism for all businesses regardless of their ownership, economic sector, and trade. There will be four main forms of business, i.e. (i) the limited liability company, (ii) the joint stock company, (iii) the partnership company, and (iv) the private enterprise. From March 2005, ministries and relevant agencies began to gather inputs and comments to the draft law from local and foreign enterprises, business associations (including VCCI, an association of local Vietnamese enterprises, Eurocham, the Europe-Vietnam Chamber of Commerce, and Amcham, the American-Vietnam Chamber of Commerce), research institutes, universities, media and NGOs (including the World Bank Group and UNDP). Before the final draft laws were submitted to the National Assembly for approval, 16 seminars and symposiums had been organised to gather inputs and comments to the laws, which subsequently lead twice to amendment of the draft reflecting comments received.

72. Although creating a national platform with a long term horizon may be one of the preferred options to secure a continued awareness focus, sometimes it is better feasible to start with awareness raising on an *ad hoc* basis. This has been done in Pakistan through the joint organisation of two consecutive annual national conferences on corporate governance by the Pakistan SECP and Lahore business school and the Institute of Chartered Accountants of Pakistan. In Chinese Taipei the government both organised national conferences on corporate governance and supported corporate governance seminars. In Vietnam the Ministry of Finance in co-operation with the OECD and IFC likewise organised in December 2004 the International Corporate Governance Meeting with as its primary purpose to raise awareness. While in May 2005 in Bangladesh the University of Dhaka together with the Dhaka Stock Exchange in co-operation with the Asia Foundation and the OECD organised the first International Conference on Corporate Governance in Bangladesh. Similarly the Asian Development Bank and the Bangladesh SEC organised workshops on corporate governance in 2003 respectively 2004.

1. Since an English translation of the UEL was not available at the time of drafting of this report, most of the information in this report regarding the UEL has been collected from the English language websites of VCCI, Vietnam Business Forum and the IFC-MPDF programme.

1. 3 Obstacles to progress

73. It appears that the balance between public sector and private sector initiated efforts differs largely around the region. Therefore policymakers should continue (to assess) whether incentives are needed to develop closer cooperation between public and private sector initiatives. This will be more cost efficient and has the benefit of cross fertilisation.

74. The public debate on corporate governance in the Roundtable economies would benefit from policy makers being transparent about the approach followed regarding reforms as well as the rationale behind them. This would enhance the efficiency of the legislative and/or regulatory drafting process. For this to be realised the political will for change is needed. Until then lack of transparency remains an obstacle to speed up progress.

75. Also in drafting new corporate governance related regulation and legislation, policymakers (including both the government and other regulatory authorities) should make use of effective and continuous consultation with the public, companies and shareholders including their representative organisations, and other stakeholders, as a proven tool for awareness raising. Moreover to underline the importance of public consultation the policymakers should also make all comments publicly available and justify the rationale for the final decision made.

1.4 Issues for further improvement

76. Policy makers should make use of public consultation when drafting corporate governance regulation and legislation. This has proven to be an effective tool around the world for raising awareness, since it provides in particular the corporate sector and the professional bodies (accountants, bar associations) the opportunity to share their views with policy makers.

77. Continuing director training should be encouraged and promoted. New legislation and regulation on corporate governance is most often directed first to directors and board members. It is they who are to implement, comply with and be accountable for such new regulatory framework. Therefore continuing (permanent) education programmes for directors is of the essence. Although training of directors is becoming widespread in Asian economies in some countries there is a need for sustaining these efforts by institution building. Institutes of directors can play an important role in this respect. For example, in view of Vietnam’s pending equitisation (incorporation) programme policymakers induce and assist to establish an institute of directors which may play a role in awareness raising through training programmes for directors.

78. Many Asian economies have recently realised that in order to effectively promote awareness in corporate governance co-operation between public and private sector is of the essence. Solid, and possibly sustainable, institutionalised examples thereof include the establishment in India, Indonesia, Pakistan, Singapore and Thailand of national committees on corporate governance, respectively the National Foundation for Corporate Governance (2004), the National Committee for Corporate Governance (2001), Institute of Corporate Governance in Pakistan (2004), the Council on Corporate Disclosure and Governance in Singapore (2002), and the National Corporate Governance Committee in Thailand (2002), in which both public and private sector representatives cooperate; Malaysia had already established the Malaysian Institute of Corporate Governance (its founding members comprised of five industry associations, i.e the Federation of Public Listed Companies, Malaysia Institute of Directors, Malaysia Institute of Accountants, the Malaysian institute of Chartered Secretaries and Administration and the Malaysian Institute of Certified Public Accountants) in March 1998.

79. Policymakers, the private sector and academics should engage the press in further developing public awareness about corporate governance. The initiatives described above prove that progress is on its way in securing implementation of Priority 1 of the White Paper. However, whenever possible the (financial) press should be engaged in corporate governance developments; critical coverage of corporate governance developments by qualified journalists in OECD countries has proved to be useful in developing public awareness (an Asian example hereof is the television programme broadcasted by Shanghai TV in which an academic from Hong Kong China openly discusses corporate governance issues within Chinese and Hong Kong China listed companies).

2. *Priority 2*

Effective implementation and enforcement of corporate-governance laws and regulations

2.1 Progress since 2003

80. Since the publication of the White Paper in 2003 considerable reforms have been implemented in the Roundtable economies. Different policymakers have been involved, ranging from securities commissions and stock exchanges to central banks and companies commissions. In itself this seems to prove that policymakers indeed are aware of the need for proper implementation and enforcement. As shown hereinafter most initiatives relate to secondary regulation by regulators and stock exchanges, i.e. not the legislators. There is a positive reason for this since in most economies company and securities legislation were already in place at the time the White Paper was issued.

81. Much focus has been on regulatory capacity building, most often intended to supervise and sustain implementation of corporate governance legislation and regulation. Examples discussed hereinafter include China, Hong Kong China, India, Malaysia, Singapore, Chinese Taipei and Thailand.

82. One of the instruments used for driving the corporate governance framework ahead is the use of voluntary or mandatory codes, principles, guidelines or best practices. Since January 2003 in Bangladesh, Hong Kong China, Indonesia, Singapore and Korea new codes have been adopted, while the codes in Pakistan, Chinese Taipei and Thailand were all adopted in 2002 (see Box 4. for an overview).

83. Codes of best practice provide benchmarks for measuring corporate governance practices. The measurement itself is a highly controversial issue (see also Box 3.). Assessing and understanding the underlying methodology is of the essence when using such rating and scoring tools. In particular the private sector has been engaged in developing rating tools and scorecards for investors to use in evaluating for instance companies' corporate governance performance but also countries' corporate governance policy framework. Recently also Asian academics have started researching the topic. Keeping in mind the controversy surrounding corporate governance ratings and scorecards, the emergence of this sector in itself may encourage the corporate governance debate in Asia.

Box 3. Corporate Governance Rating

In most countries corporate governance consulting firms and rating agencies are actively developing rating tools benchmarked to existing best practice. Just as investors require credit ratings of corporate entities from independent credit rating firms before making decisions on certain investments and debt instruments, investors also require independent reviews and evaluation of a company's corporate governance practices from rating firms. Although the quality of their services may vary and the methodology they use is not always disclosed, most rating agencies are now offering corporate governance services, based on accepted standards to:

- Facilitate company analysis for financial analysts and investors
- Help companies improve their corporate governance structures and practices

Source : Global Corporate Governance Forum, Toolkit Volume 1, Developing Corporate Governance Codes of Best Practice (2005)

2.2 Key developments

84. Pursuant to a technical assistance programme entered into between the ADB and the Government of **Bangladesh** in December 2003, parties are committed to strengthen the enforcement capability of the SEC, by (i) vesting it with full powers to investigate, levy penalties, and impose administrative sanctions, including laying down cease-and-desist orders, and must have other means to address malpractices in the financial markets. SEC's powers, and ability to secure information, investigate and pursue criminal and civil cases against wrongdoers will have to be reviewed based on best practices and the provisions of local laws and rules; and (ii) SEC's capacity to regulate and supervise the domestic capital market needs to be improved. Pursuant to that same programme corporate governance should be strengthened by adopting best practices on (a) the structure of the boards of directors and the role of independent directors; (b) protection of minority shareholders; (c) transparency; (d) setting up a commission to revise the Companies Act 1994; and (e) formulating a code of corporate governance. Due to these efforts capacity building as well as system development within the regulators has improved. Also the SEC's authority to impose appropriate sanctions for non-compliance has improved and the practice of making use of this power is developing gradually; while the SEC indeed has imposed hefty fines on defaulters, stock exchanges have threatened to de-list non-complying companies. Still, an obstacle for proper civil enforcement remains the judiciary; judges are not trained on corporate fraud or governance issues; in addition resolution of cases brought to the courts in general lack the necessary speed. Furthermore, there is no regulation in

place requiring listed companies to report on corporate governance in annual report. And, as also set out under Priority 5 hereinafter, the legislation does not yet provide for class actions.

85. In **China** developments have been driven by different regulators, amongst others:

- In March 2003 the National Congress established the State-owned Assets Supervision and Administration Commission (SASAC) to reform the organisations, assets and enterprises under supervision of the State Council. The establishment of SASAC is an important step towards reinforcing the role of the state as an owner and shareholder. The fundamental idea underpinning SASAC is to exercise ownership rights in a centralized and unified manner, while complying with the Company Law
- The Chinese Ministry of Public Security established the Bureau for Investigation of Securities Crime on the premises of CSRC in order to facilitate the handling of criminal cases in securities crime
- In 2004 CSRC also started to reform its supervisory regime of listed companies. A geographically-based listed company supervision responsibility system was established, whereby the regional bureaus of CSRC will handle daily and regular supervision of listed companies and carry on on-site inspections, and the two exchanges will be the frontline regulators for information disclosure. These measures, by clearly defining the division of labour and responsibilities among the CSRC, its regional offices, and the stock exchanges, while consolidating regulatory resources, aim to increase regulatory efficiency and power
- Furthermore the Shanghai and Shenzhen Stock Exchanges have both issued public sanctions to some listed companies suspected of illegal activities
- Institutional investors may play an active role in enforcement in China. They are expected to have doubled their investment in the stock market in 2004. The CSRC supports this trend, for which reason it recently introduced the Qualified Foreign Institutional Investor scheme, which provides for opening (under certain restrictions) the market for foreign direct institutional investments in a wider range of securities. The scheme aims to contribute to diversifying ownership and consequently improve corporate governance
- Pursuant to the new Securities Law the CSRC has also the power to freeze corporate or individual capital, securities and bank accounts in

cases of suspected illegal activity. Suspected stock manipulation or insider trading may also lead the CSRC to suspend trading activity for 15 days (which may be extended) for the suspected persons involved

86. In addition to the publication, in November 2004, of the new Code on Corporate Governance Practices (see also Box 4. for an overview of codes in the Roundtable economies), in June 2005, the **Hong Kong China** Government introduced a bill to establish a Financial Reporting Council (FRC) (the FRC Bill). Under the FRC Bill, the FRC will have among its primary tasks (i) investigating auditors in respect of irregularities in the auditing of financial statements of listed entities, as well as (ii) enquiring into non-compliance with legal, accounting or regulatory requirements in financial reporting by listed entities. The FRC will have extensive powers to enforce its mandate, e.g., to obtain evidence from auditors, listed companies and third parties, including banks. Furthermore proposals for legislation have been put forward to grant the statutory securities market regulator, the Securities and Futures Commission (SFC), the responsibility for enforcing listing rules in relation to (i) financial reporting, (ii) disclosure of price sensitive information, and (iii) shareholder approval for certain transactions. Under the proposals, the SFC will have the powers to impose appropriate penalties, including fines and disqualification orders, against directors that fail to comply with their obligations.

87. In **India** the department of Company Affairs which was previously under the Ministry of Finance became the Ministry of Company Affaires in May 2004. The Securities and Exchange Board of India (SEBI) enforces compliance and observance of the corporate governance principles included in the listing requirements. In addition the Reserve Bank of India is in charge of banks and financial institutions. Finally, the Company Regulator regulates all companies in India. And although the J. Irani Expert Committee on Company Law (Expert Committee) in its report of 31 May 2005 stated that there is no need for one regulator to exclusively deal with supervision of listed (companies), it emphasised that there is a need for further effective implementation of laws and regulation, for example by increased disclosure to ensure effective capital markets supervision.

The Expert Committee in its report included recommendations regarding, amongst others, the following corporate governance related issues: (i) Minimum and Maximum Number of Directors; (ii) Manner of appointment, removal and resignation of Directors; (iii) Independent Directors; (iv) Sitting Fees to Non-Executive Directors; (v) Disclosure of Remuneration; (vi) Audit Committee for Accounting and Financial matters; (vii) Stakeholders' Relationship Committee; (viii) Remuneration Committee; (ix) Vacation of office by the Directors; (x) Knowledge Test;

(xi) Rights of Independent/Non-Executive Directors; (xii) Meetings Of Directors- Related Matters; (xiii) Quorum for emergency meetings; (xiv) Related Party Transactions; (xv) Certain transactions, in which directors are interested; (xvi) Disclosures.

The corporate governance norms in the listing agreement ("clause 49") have been amended substantially to improve the croporate governance framework, and will be effective from December 2005. Changes are made regarding (i) a board Code of Conduct; (ii) Subsidiary Companies; (iii) Related Party Transactions; (iv) Proceeds from public issues, rights issues, preferential issues; (v) CEO/CFO certification of review of financial statements; (vi) Definition of independent director refined; (vii) Whistle Blower Policy (non mandatory).

88. In **Indonesia** the World Bank and the IMF in close consultation with BAPEPAM, the Jakarta Stock Exchange and the National Committee for Corporate Governance (NCCG) in August 2004 released the "Report on the Observance of Standards and Codes" which analyses Indonesia's progress on implementation of good corporate governance. The NCCG also issued in January 2004 (i) the Indonesian Banking Sector Code which aims to improve corporate governance of banks, and (ii) the Guidelines on the Independent Commissioners and Effective Audit Committees.

89. Recent research (Black et al. 2005) suggests that corporate governance in **Korea** has improved. The Code of Best Practices for Corporate Governance which was first drafted in 1999 was substantially amended, after public consultation, and a new version has been adopted in September 2003 by the Committee on Corporate Governance; in this committee each of the Korea Stock Exchange, the Korea Securities Dealers Association, the Korea Listed Companies Association, the Kosdaq, the Korea Investment Trust Companies Association and the Kosdaq Listed Companies Association participate. The substance of new code has been harmonized with global standards and amended to comply more realistically than the old 1999 code with the Korean context. An issue which remains to be considered for clarification and/or restructuring are the responsibilities of the different agencies involved in corporate governance regulation, notably the Korea Fair Trade Commission, the Financial Supervisory Commission and the Financial Supervisory Service. Another aspect which is relevant for improving corporate governance is to ensure proper exit mechanisms for shareholders. In view thereof Korea is working on a new unified insolvency law which is to be implemented in 2006; it will consolidate the Bankruptcy Act, the Company Reorganisation Act, the Composition Act and the 2001 Corporate Restructuring Promotion Act.

90. Responsibility for corporate governance enforcement in **Malaysia** is shared among the Securities Commission (SC), the Royal Malaysian Police, the Companies Commission Malaysia (CCM), the Anti-Corruption Agency and the Central Bank; in addition the stock exchange Bursa Malaysia Berhad plays a critical role. In May 2004 the High-Level Committee on Corporate Governance Enforcement was established with the task to coordinate effective corporate governance enforcement by each of the SC, the Police and the CCM. To further improve enforcement, the Securities Industry Development Centre (SIDC) has also conducted a special Judges Programme to assist Malaysian judges in understanding the securities laws framework. Additionally, the Finance Committee Report on Corporate Governance recommended the possibility of introducing alternative dispute resolutions mechanisms with the objective of providing for the commercial and corporate sector with a system manned by specialists which will ensure that the system will be responsive to the needs and demands of the business community and able to dispose cases in an efficient manner.

In January 2004 amendments to the Securities Industry Act 1983 to enhance enforcement / investor redress mechanisms were introduced. Pursuant thereto the SC has been granted an enhanced range of sanctions that it can impose for breach of, *inter alia*, the exchange listing requirements. The range of sanctions include pecuniary penalties, reprimands, directions for *compliance*, and directions to remedy or mitigate the effect of the breach, including the power to direct the making of restitution to any persons aggrieved by such breach. Provisions were also introduced to enhance investor avenues for judicial redress in the case of contraventions of, *inter alia,* the Securities Industry Act 1983 or the exchange listing requirements through provisions which now enable aggrieved persons to seek a wide range of orders by applying to the High Court, including an order restraining the breach of a relevant requirement and orders for the purpose of remedying or mitigating the effect of the contravention, including the making of restitution to any persons aggrieved by such breach. This development is in line with the general effort by the SC to broaden avenues for private enforcement by the market and strengthens the ability of the regulatory framework to facilitate stronger and more effective market-based regulation.

Moreover, the January 2004 amendments to the Securities Industry Act 1983 introduced the novel concept of whistle blowing into securities law. The two key components of the whistle blowing provisions include (i) mandatory duty for auditors to report to the relevant authorities breaches of securities laws and listing requirements. This requirement supplements existing requirements in the Companies Act imposing a similar duty on auditors to report to the relevant authorities breaches of company law; and (ii) protection against retaliation for specific categories of persons, namely chief executive officers, company secretaries, internal auditors and chief financial officers who report to the authorities on company wrongs. The protection against retaliation includes protection against discharge, discrimination, demotion and suspension by the company on the whistle blower. The whistle blowing provisions are envisaged to further enhance enforcement by the regulators.

Effort to undertake a comprehensive review of the Malaysian Companies Act 1965 was started by the establishment of the Corporate Law Reform Committee (CLRC) on 17 December 2003 by the Companies Commission of Malaysia. The CLRC has been entrusted to undertake a fundamental review of the current legislative policies on corporate law in order to propose amendments that are necessary for corporate and business activities to function in a cost effective, consistent, transparent and competitive business environment in line with international standards of good corporate governance. In this connection, it is anticipated that an in depth study will be conducted to consider the existing corporate law and practices in Malaysia as well as other similar concluded international practices. The findings of the review will then be translated into recommendations for reforms in modernizing corporate laws in Malaysia.

91. It is in particular the weak implementation and enforcement of the rules rather than their formulation which creates problems in **Pakistan**. In view thereof a study conducted in 2003 recommended that a separate department within the Enforcement division of the SECP should be set up to specifically deal with enforcement of the Corporate Governance Code. In another study regarding the implementation conducted in 2004, on the assessment of the Corporate governance regulations, it was found that some stock brokers and leading businessmen are highly sceptical about the capacity of the SECP to implement the reform in a transparent and accountable manner. They are of the view that the regulators should neither have discretionary powers nor judicial powers.

After the stock market crises in March 2005, in which small investors suffered huge losses, a task force was established in April 2005 to idenfify the causes of the crash. The task force has made several policy recommendations of operational and structural nature with regard to the enforcement of corporate laws and regulations (Stock Market Review Taskforce, June 2005). The recommended steps include demutualization of the exchanges, appointment of a non-broker chairperson on the Board of Directors of the Stock Exchanges, strengthening of the National Clearing Company, strengthening of capital adequacy requirements and introduction of a code of conduct for investment advisers, research analysts and media commentators. The SECP has taken various steps in pursuance of the recommendations by this task force. On the whole it has taken actions or initiated actions on 394 cases or complaints from January to October 2005 which include registered companies, directors, managers, and brokerage houses as well SECP own actions against them. Thus the SECP is maintaining a strict vigilance of the companies to ensure compliance with the regulations.

92. In the **Philippines** the overall enforcement and implementation framework of corporate governance regulation has improved, however, more concrete effort seems necessary from policymakers that in general do "encourage" enforcement corporate governance. One of the actions undertaken has been the issue of a Circular (5, 2003) by the SEC which prescribes listed companies to submit a corporate governance self-assessment report. The SEC has now incorporated in its operational procedures the monitoring of compliance with corporate governance regulations by listed companies. Reports of listed companies are being evaluated to determine the level of their compliance with their governance policies. Sanctions have been imposed on those companies found to have deviated from their representations, for example to create a nomination committee and other board committees.

93. In **Singapore,** the government had appointed a high-level committee called the Company Legislation and Regulatory Framework Committee (CLRFC) in December 1999 to undertake a comprehensive and coherent review of the company law and regulatory framework. In October 2002, the government accepted all 77 recommendations made by the committee and implementation of these recommendations has been carried out over the last 4 years. Out of the 77 recommendations, 19 recommendations concerned corporate governance issues. Amongst the measures implemented is the provision of a list of directors' duties in the directors' consent to act. It was also recommended that the Singapore Institute of Directors (SID), in consultation with the securities exchange (Singapore Exchange), conducts extensive and systematic training and accreditation for directors in Singapore and in this regard, the SID in collaboration with a leading local university will be introducing a certification and diploma course for directors in early 2007. It has also in collaboration with the Singapore Exchange developed a number of training courses in both English and Mandarin for directors of Singapore listed companies. A new statutory board called the Accounting and Corporate Regulatory Authority (ACRA) was formed on 1 April 2004 with the merger of the Registry of Companies and Businesses and the Public Accountants Board to handle all matters relating to the registration of business vehicles (companies, businesses and limited liability partnerships), public

accountants, public accounting firms and public accounting corporations as well as the required public filings by these individuals and/or entities. An additional function of the authority is monitoring companies' compliance with the prescribed accounting standards which became law for financial years commencing 1st Jan 2003. A Practice Monitoring Programme (PMP), a programme designed to ascertain whether a public accountant has adhered to prescribed auditing standards and guidelines when providing public accountancy services (which includes auditing of companies), was also legislated under the Accountants Act in April 2004. ACRA's PMP focuses on public accountants who audit public interest entities (i.e. companies listed on the securities exchange, companies in regulated industries and other entities which raise public funds, such as charities) whilst PMP carried out by reviewers from the professional body for accountants called the Institute of Certified Public Accountants of Singapore (ICPAS), with effect from April 2006, focuses on auditors who audit non public entities. Since January 2003, the Singapore Exchange Listing Manual requires listed companies to describe their corporate governance practices with specific reference to the principles of the Code of Corporate Governance in its annual report. Listed companies must disclose any deviation from any guideline of the Code together with an appropriate explanation for such deviation in the annual report. The Code was subsequently reviewed and revised by the Council on Corporate Disclosure and Governance (CCDG) following a public consultation in 2005. The objective of the review was to introduce improvements to the Code, taking into account feedback received since the inception of the original Code and international developments in corporate governance. The revised Code was accepted by the government and came into effect in July 2005.

94. In July 2004 the **Chinese Taipei** government set up the Financial Supervisory Commission (FSC); it is in charge of implementation and enforcement of all corporate governance related regulation; apart from monitoring it also has extensive powers and resources to examine and investigate cases. The FSC acts independent from the government. The Bureau of Monetary Affairs which regulates banking institutions, the Insurance Department which regulates insurance companies and the Securities and Futures Commission which regulates securities firms and asset management firms, were all three ceded by the Ministry of Finance to the FSC. Furthermore, the investigation and enforcement power of the FSC is empowered by the Securities and Exchange Act to conduct investigations and impose administrative sanctions for violations thereof, and also, to assist with criminal prosecution proceedings.

95. To improve criminal prosecution, the **Thai** government established the Department for Special Investigation (DSI) in 2004. The SEC can file all cases on corporate fraud or false disclosure as well as insider trading and market manipulation with the DSI. The clear improvement comparing to the filing with the Royal Police is, amongst others, that DSI works as a team; this means that after the SEC filed a case with the DSI, it will appoint a working group to handle the case. The working group for SEC filed cases comprises DSI officers, SEC investigator, public attorney and Bank of Thailand officers. The DSI is well staffed (over hundred employees) and budgeted, while it has extensive investigative powers.

The SEC has also raised the effectiveness of administrative sanctions. Especially, sanctions against auditors, and those who provided securities-related services to investors. The introduction of the SEC Director Registry has also added another tool to impose administrative sanction. As a result, directors of listed companies who fail to perform fiduciary obligations will be removed from the "white list" and thus unable to maintain their directorships at any listed company. The SEC has put the names and details of director in the white list in its web site. Prior to the issuance of an administrative order on any director, the SEC will seek advice from the Steering Committee on Director Discipline (comprising of numbers of outside experts), in order to ensure transparency and integrity of the decision-making process.

The SET has regularly revised its listing requirements to better monitor the good corporate governance practices, i.e.: all listed firms must establish an audit committee and an internal control system; all related party transactions must be disclosed and carried out according to SET guidelines; if any companies fail to submit financial reports, the trading of their stocks will be temporarily suspended; all companies must comply with and practice the 15 Corporate Governance Principles of the SET or publicly explain why they are unable to comply. The SET has further encouraged listed firms to comply with its 15 Corporate Governance Principles by presenting a "Best Corporate Governance Report Awards" to those companies that best follow the principles. The SET also offers a 50 % reduction in annual fees for those which received a corporate governance rating of "good" or "very good".

96. The most important development in **Vietnam** is the adoption on 29 November 2005 by the 11th National Assembly of Vietnam of both the new Unified (or "revised") Enterprise Law (UEL) and the Common Investment Law (CIL). The new laws will enter into force on 1 July 2006, replacing the current Enterprise Law (2000) and Foreign Investment Law. Under the new regime foreign and domestic investors will be governed by the same laws. The UEL tackles some of the shortcomings of the old

Enterprise Law. Although the UEL is intended to apply to all companies, SOEs will be exempt for a certain period of time up to the moment they are transformed into real "companies" through the pending equitisation process. The UEL introduction and its implementation and enforcement will not be fully effective unless other laws and regulations pertaining to business - such as the SOE Law and the CIL - are consistent with it. Thus a comprehensive review of all relevant legal documents is necessary in order to resolve all inconsistencies.

2.3 Obstacles to progress

97. Often opaque regulatory frameworks with many constituencies each having certain powers may impede the quality and strength of effective implementation and enforcement of corporate governance legislation and regulation. Therefore the legislator should first clearly define the objectives of the legislation and regulation imposed, as well as the role of the regulators on the one hand and the market players on the other hand. This asks for political will and commitment.

98. Surveillance, investigation and prosecution of corporate governance violations often involve the overlapping jurisdictions of several regulators. For example in some countries each of (i) the Ministry of Justice, (ii) the Ministry of Industry, (iii) the Ministry of State Owned Enterprises, (iv) the securities market regulator, (v) the stock exchange, and (vi) the central bank play an important role in implementation and enforcement of corporate governance legislation and regulation, however, there is no clear transparent policy in place distributing the different responsibilities (and the accompanying powers).

99. The administrative costs involved in solid implementation, supervision and enforcement may be considered to be a burden. Such administrative costs can be a burden for both the regulators who impose the regulation and the market participants that have to comply with the rules. According to recent World Bank publications (Doing Business in 2005: Removing Obstacles to Growth) the administrative costs of complying with regulations is three times higher for businesses in poor countries than for those in rich ones. And yet businesses in poor countries have less than half the protection of their property rights.

100. Due to political interference the implementation of a balanced enforcement framework may also be an obstacle. Competition will be affected if some market players have better conditions than others due to uneven enforcement of corporate governance regulation. This can be a particular a problem in countries with many state owned enterprises (e.g. China, Vietnam).

Box 4. Adoption of codes, principles and guidelines in Roundtable economies

- Bangladesh: voluntary Code of Corporate Governance for Bangladesh, March 2004, initiated by the Bangladesh Enterprise Institute; and the SEC issued a new mandatory Code on 9 January 2006
- China: the CSRC Guidelines on Independent Directors, August 2001; and the Code of Corporate Governance for Listed Companies, 2002, enacted by both the CSRC and the SETC
- Hong Kong China: Code on Corporate Governance Practices and requirements for a Corporate Governance Report, 19 November 2004, initiated by the Stock Exchange of Hong Kong China
- India: Report of the Kumar Mangalam Birla Committee on Corporate Governance, February 2000, initiated by SEBI; also Clause 49 of the SEBI listing requirements prescribing both mandatory and non-mandatory corporate governance provisions to be complied with as of 1 January 2006 by listed companies
- Indonesia: Code for Good Corporate Governance, April 2001, initiated by the National Committee for Corporate Governance; review is pending; and the Good Corporate Governance Guidelines for the Indonesia Banking Sector, January 2004, also initiated by the National Committee for Corporate Governance
- Malaysia: Code on Corporate Governance, March 2000, initiated by the Securities Commission
- Pakistan: Code of Corporate Governance, March 2002, initiated by the Securities and Exchange Commission of Pakistan
- Philippines: Code of Proper Practices for Directors, 30 March 2000, initiated by the Institute of Corporate Directors
- Singapore: revised Code of Corporate Governance, 14 July 2005, issued by the Ministry of Finance, initiated and developed by the Council on Corporate Disclosure and Governance, effective from Annual General meetings held on or after 1 January 2007
- Korea: Code of Best Practice for Corporate Governance, September 1999, initiated by the Committee on Corporate Governance and updated as per September 2003

- Chinese Taipei: Corporate Governance Best Practice Principles, 2002, initiated by the Stock Exchange and the GreTai Securities Market; and the Corporate Governance Best-Practice Principles for Banks and the Corporate Governance Best-Practice Principles for Financial Holding Companies, both adopted on 31 December 2003 by the Bankers' Association
- Thailand: Code of Best Practice for Directors of Listed Companies, October 2002, initiated by the Stock Exchange of Thailand; an updated version is scheduled for 2006 (taking effect as of 2007)
- Vietnam: no specific corporate governance code adopted; however, the new Unified Enterprise Law (effective as of 1 July 2006) addresses specific corporate governance issues

Source : European Corporate Governance Institute Index of Codes (http://www.ecgi.org/codes/all_codes.php) and responses to 2005 OECD Asian Roundtable on Corporate Governance Questionnaire

101. The lack of knowledge and experience within the judiciary forms a serious constraint for solving corporate governance related disputes, as well as for providing exit options for shareholders and creditors either via liquidation of bankruptcy proceedings.

102. Legal transplant may be another administrative obstacle to progress. In some of the Roundtable economies the legal framework consists of different elements transplanted from different legal cultures (common versus civil law system). Although incorporating best practices from around the world at national level sounds logical, in the long run effective implementation and enforcement thereof will prove difficult and thus costly unless there is a coherent strategy.

103. A general concern on the implementation and enforcement of corporate governance legislation and regulation in the Roundtable economies remains the approach taken by the different stakeholders involved. A mentality focusing on box ticking of the formally required steps from the rule book rather than complying with the spirit of, and rationale behind, corporate governance legislation and regulation may prove a serious obstacle for sustainable improvement of the corporate governance framework in Asia.

2.4 Issues for further improvement

104. Effective enforcement starts with the need for both national and local authorities, as well as enforcement entities, to commit to the rule of law.

105. Legislators should clarify the accountability of regulatory agencies. In particular in the case where the respective regulators ultimately all report to the state. In these cases the accountability of the respective regulators, rather than just their reporting lines, need to be clearly defined.

106. A transparent and functional division of responsibilities between regulators, stock exchanges and other self-regulating organisations needs to be implemented, and an effective system of cooperation between them should be developed.

107. The enforcement capability of regulators needs to be strengthened. To increase effectiveness and speed of enforcement there is a need to secure proper resources, financial and human, for the enforcement entities. Also in relation to enforcement of corporate governance regulation, introducing or tightening sufficiently deterrent penalties for non-compliance needs to be considered.

108. Specify status of corporate governance codes and principles. When codes and principles are used as a national standard or as an explicit substitute for legal or regulatory provisions, their status in terms of coverage, implementation and enforceability should be clearly specified.

109. There is a clear need to further develop the capacity to adjudicate corporate governance related disputes, either through specialised courts or alternative dispute resolution.

110. Political interference by the state should be prevented. In some countries the predominant role of the state is a source of potential conflict of interests because of the different capacities of the state in enforcing the corporate governance framework (as shareholder, as regulator and as enforcing authority).

3. *Priority 3*

Asian Roundtable Countries should work towards full convergence with international standards and practices for accounting, audit and non-financial disclosure

111. Hereinafter IFRS refers to all standards and related interpretations issued by the International Accounting Standards Board (IASB) and its predecessor, the International Accounting Standards Committee (IASC). IASC-issued standards are known as International Accounting Standards (IAS), while International Standards on Auditing (ISA) refers to the international standard on audit requirements.

3.1 Progress since 2003

112. **This is one area where progress seems to have been made.** Accounting and auditing standards have been introduced, amended or radically changed in the Asian Roundtable economies since publication of the White Paper. While changing and updating the policy framework in this field, benchmarking with international standards and best practices has been the rule. Often undertaken by new national standards setters or oversight bodies (India, Malaysia, Singapore, Thailand, or currently under consideration, i.e. Bangladesh) convergence with international standards and practices for accounting, audit and non-financial disclosure indeed seems on its way; however, *full* convergence is in most cases not realised yet (although with the latest accounting standards (to be) adopted by Malaysia as per 1 January 2006 it will be largely in compliance with IFRS).

113. The introduction of audit committees for listed companies is another recent important change. In most Roundtable countries audit committees in boards of listed companies are now mandatory. This, together with the introduction of mandatory auditor rotation, reinforces the key role of proper audit processes and auditing in listed companies.

3.2 Key developments

114. In general the quality of auditing and accounting has improved in **Bangladesh**, underlined by the quality of annual reports, however, the quality of auditing by other than firms with international affiliations remains poor. Pursuant to a technical assistance programme entered into between the Asian Development Bank (ADB) and the Government of

Bangladesh in December 2003 parties are committed to improve quality of accounting and auditing practices. Amongst others because as of end-April 2003, the Institute of Chartered Accountants of Bangladesh (ICAB) had adopted only 8 of the 34 IAS and 14 of the 46 ISA. However, ICAB did not even have the authority to regulate the accounting profession and to ensure that such standards are followed and disclosure norms are faithfully complied with. Therefore the accounting and auditing improvement programme has three elements: (i) phased adoption of IAS and ISA and how it can be expeditiously carried out, (ii) setting up of an accountancy board to implement and monitor compliance with international standards, and (iii) strengthening ICAB to enable it to operate as a self-regulatory body. It is proposed that the accountancy board be responsible for accrediting accounting practitioners and auditing firms and for enforcing professional standards and ethics. Such a board may need to be independent from the audit profession. Currently (August 2005) the government is still contemplating to establish an accounting oversight board to supervise and monitor the auditors.

In the meantime the Bangladesh SEC did issue regulations regarding disclosure requirements of substantial shareholdings and changes thereto; this may further strengthen the non-financial disclosure framework. In addition, and apart from the statutory periodic disclosures, specific procedures have been imposed by the SEC on listed companies and their management regarding disclosure of price sensitive information, including maximum permissible time lags (30 minutes).

115. Since 2002 listed companies in **China** are required to publish un-audited quarterly reports; recently the CSRC has revised its rules to simplify and streamline the format of these reports in order to secure better understanding by investors. The Ministry of Finance (MOF), which is in charge of setting the accounting standards in China, has made changes in recent years to Chinese accounting standards to bring them more in line with IAS. For example MOF issued a new accounting standard regarding the Recognition and Measurement of Financial Instrument; it will be implemented on 1 January,2006 first by all commercial banks on experimental basis. This newly introduced accounting standard is substantially convergent with IAS 39 in terms of definition and classification of financial assets and liabilities, fair value accounting, provisioning on impaired assets and so on. In October 2003, the MOF and the CSRC jointly introduced a new requirement for the rotation of auditors, which requires that an auditor cannot provide auditing services to the same listed company for more than five years. The rotation of auditors will help maintain the independence of auditors. Furthermore CSRC is considering to require listed companies to provide more detailed

information on corporate governance disclosure in their annual reports. That means that companies should give more explanation on the divergence of their corporate governance practices from the Chinese corporate governance code which is based on international standard.

116. The **Hong Kong China** accounting and auditing standards have fully converged with IFRS and IAS for financial years starting 1 January 2005. The disclosure obligations in the Listing Rules are in line with the principles set out in the IOSCO's Principles for Ongoing Disclosure and Material Development Reporting by Listed Companies. Pursuant to the FRC Bill, referred to above, the FRC will have among its primary tasks (i) investigating auditors in respect of irregularities in the auditing of financial statements of listed entities, as well as (ii) enquiring into non-compliance with legal, accounting or regulatory requirements in financial reporting by listed entities; it is anticipated that financial disclosure will benefit from the establishment of the FRC. Also, the new Code on Corporate Governance Practices and the requirements in relation to the Corporate Governance Report set high standards for reporting. These, coupled with the proposals to transfer responsibility for enforcing listing rules relating to financial reporting to the SFC, and the proposed establishment of the FRC, send a clear message to the market that disclosure of information is an essential element of the responsibilities of a listed company. To ensure the quality of auditing, the Hong Kong Institute of Certified Public Accountants (HKICPA) maintains responsibility for the oversight of auditors and operates a practice review system, which is currently being streamlined. The HKICPA has also established a practice review oversight board, with majority lay participation, to oversee the practice review system.

117. In **India** the Companies Act requires the preparation, presentation, publication, and disclosure of financial statements, and an audit of all companies by a member-in-practice certified by the Institute of Chartered Accountants of India (ICAI). ICAI introduced a mandatory requirement for continuing professional education (CPE), effective as of 1 January 2003. The ICAI has issued and revised several accounting standards over the last couple of years, significantly reducing the gap between the Indian Accounting Standards and IASB-issued international standards. New Indian corporate governance related standards correspond to the following international standards: IAS 14, Segment Reporting; IAS 24, Related Party Disclosures; IAS 17, Leases; IAS 28, Investments in Associates; IAS 3 1, Interests in Joint Ventures; IAS 34, Interim Financial Reporting; IAS 38, Intangible Assets; IAS 35, Discontinuing Operations; IAS 36, Impairment of Assets and IAS 37; Provisions, Contingent Liabilities and Contingent Assets. Regarding non-financial disclosure, the listing

agreement now requires that the listed companies disclose all price sensitive information / information relating to material events immediately to the stock exchange / market. Apart from that, information relating to board meetings, announcements such as bonus, rights issue, further issues etc need to be intimated immediately after the approval of the board. In certain cases, prior intimation of the board meeting where such matters are proposed to be discussed need to be also informed to the market. Said disclosures are required to be displayed electronically through a system called 'EDIFAR'. Apart from this, all corporate announcement and disclosures can also be disseminated and disclosed to the market through an electronic compliance facility provided by the NSE called 'Electronic Issuer Interface'. Currently, this is on a voluntary basis to encourage the listed companies to become familiar with the process.

118. In January 2004 the National Committee on Corporate Governance of **Indonesia** issued the Guidelines on the Independent Commissioners and Effective Audit Committees, to clarify and strengthen the position of both independent commissioners and audit committees within Indonesian (listed) companies. Furthermore, the Indonesian regulator BAPEPAM created a new division in November 2004, the so-called Disclosure and Good Corporate Governance Division, to enhance BAPEPAM's role in the active implementation of the Corporate Governance Code. In general the Financial Accounting Standards Board (DSAK) of the Indonesian Institute of Accountants is continuing its policy of harmonising Indonesian Financial Accounting Standards (PSAK) with IFRS. Currently there is a project, expected to be finalised in 2008, to eliminate differences between Indonesian accounting standards and the IAS/IFRS. For auditing standards, Indonesia is in the process of adopting in full all the ISA. It is envisaged that by 2007 these adopted ISA will be adopted implemeted.

119. In 2003 **Korea** introduced the CEO Certification System which lead to significant improvements of accounting practices. And, similar to China, in 2003 the practice of periodic accounting firm rotation for long term auditing relations has been introduced. Furthermore, the Ministry of Finance and Economy in December 2003 amended the Securities and Exchange Act to implement the requirement of audit committees for listed companies and banks with a turnover of more than 200 trillion Won. The amended act came into force in April 2004, and underlines the importance of the audit process.

120. In **Malaysia** the Financial Reporting Foundation and the Malaysian Accounting Standards Board (MASB) have changed the nomenclature of MASB Standards. Beginning 1 January 2005, existing MASB Standards have been renamed Financial Reporting Standards (FRSs), and the numbers will change to correspond to those of the international standards.

The new names and numbers must be used in financial statements for annual periods beginning on or after 1 January 2005. Companies are encouraged to use them earlier. Furthermore, amendments to the Financial Reporting Act 1997, which take effect from 1 Jan 2005 allow foreign companies listed on the stock exchange of Malaysia to use IFRS in preparing their financial statements. Also, the Companies Commission of Malaysia and the SC may now impose sanctions on auditors for breaches of specific requirements applicable to auditors under company and securities law respectively. Additionally, the Malaysian Institute of Accountants has issued the new By-Law B-1 on Professional Independence as well as amendments to the Interpretation Section of the Institute's By-Laws – Circular No 15/2004 on 1 June 2004. The changes includes, *inter alia,* a definition of the independence of auditors and the requirement to rotate the audit engagement partner of listed companies and public interest entities, every 5 years. Moreover, on 20 August 2004, the Task Force on Corporate Disclosures Best Practices, which was established by the stock exchange and consisted of representatives from the industry, launched its guidance entitled "Best Practices in Corporate Disclosure". The said guidance sets out best practices that are aimed at assisting and guiding listed companies in meeting both the letter and the spirit of the continuous disclosure obligations under the exchange Listing Requirements and Malaysian securities laws.

121. **Pakistan** has now adopted 38 out of 41 IAS issued by the IASB for application by listed companies. During 2004-2005, the IASB amended IAS 19, IAS 36, IAS 38, and IAS 39. These amendments have not yet been incorporated into the IAS adopted in Pakistan. Practice is generally to follow the amendment, but that is not a legal requirement. The Securities and Exchange Commission of Pakistan (SECP) is currently considering this issue. The SECP and the Institute of Chartered Accountants of Pakistan (ICAP) coordinate various matters relating to the accountancy profession. ICAP has launched Quality Control Review Programme, which the SEC feels needs to be further enhanced in terms of effectiveness and scope. This coordination pertains to issues relating to transfer pricing, rotation of auditors, and investigation proceedings of ICAP against its members. The coordination committee meetings between SECP and ICAP are held regularly on a quarterly basis to achieve the desired end. Furthermore the annual reports issued by listed companies are now reviewed and evaluated by a number of organizations like the SECP, ICAP, and ICMAP. In Pakistan, ICAP and ICMAP have instituted Best Corporate Reporting award for companies, which have disclosure regimes of high standards. Despite these developments, in August 2005 the SECP mitigated the law pertaining to mandatory disclosure requirements due to the difficulties faced by many companies to comply.

122. The **Philippines** Securities and Exchange Commission (SEC) issued a number of regulations in this field, including:

- According to SEC regulation all listed companies are to have their financial statements in full compliance with IFRS and IAS by 2005
- SEC Memo Circular 13 (2003) requires accreditation of external auditors and provides guidelines for the accrediation process. To help shareholders get quality information, the Circular raised the qualification and reporting standards for auditors. It also required auditors to directly report to the SEC any material fraud and error that they may find in the course of external audit if the principals refuse to disclose such items
- SEC issued rule 68.1 as part of the Implementing Rules of the Securities Regulation Code specifying minimum accounting standards and discouraging submission of audited financial statements that do not carry unqualified audit opinions. SEC considers such companies as having not submitted audited financial statements that address that accounting deficiency. SEC applies appropriate sanctions for non-submission until deficiency is corrected
- SEC issued a Circular in April 2004 requiring Audit Committees to be composed of at least two independent directors, one of whom should be the Chair
- Pursuant to SEC Memorandum Circular Nos. 2, 3 and 19, issued in 2004, IAS (now, IFRS) and ISAs have been adopted and approved by the Accounting Standards Council (ASC) and Auditing Standards and Practices Council (ASPC). This will promote the quality of financial disclosures and sustain efforts to improve the substance and process of accounting and auditing

Furthermore, in 2005 the ASC has changed the name of its old standards from Statements of Financial Accounting Standards (SFAS) to Philippine Accounting Standards (PASs) to better correspond to the IAS. Philippine versions of IFRSs will be referred to as Philippine Financial Reporting Standards (PFRSs).

123. On 16 August 2002 (i.e. before the White Paper, however its activities became mostly apparent after the White Paper) **Singapore** launched the Council on Corporate Disclosure and Governance (CCDG). Its tasks include (i) to prescribe accounting standards in Singapore, (ii) to strengthen existing framework of disclosure practices and reporting standards taking into account trends in corporate regulatory issues and international best practices, and (iii) to review and enhance existing

framework on corporate governance and promote good corporate governance in Singapore, taking into account international best practices. Subsequently the CCDG has prescribed the accounting standards, known as Financial Reporting Standards (FRSs), for Singapore incorporated companies and branches of foreign companies in respect of their Singapore operations. These companies are required under the Companies Act to comply with the FRSs for financial statements covering periods beginning on or after 1 January 2003. The FRSs prescribed by the CCDG are based closely on the IAS and IFRS issued by the International Accounting Standards Board (IASB). In January 2004, after public consultation, the CCDG issued a Guide for the operating and financial review (the OFR Guide) for listed companies. The OFR Guide is principle-based and provides guidance to listed companies for the preparation of the OFR in their annual reports. The OFR Guide also states that it is a good practice for listed companies to present their OFR in a distinct section of their annual reports. The CCDG recommends that adherence to the OFR Guide by listed companies would be voluntary, and that the OFR Guide be included as a practice note in the listing manual of the Singapore Exchange.

124. In **Chinese Taipei** several changes have been implemented regarding both financial and non- financial disclosure:

- To attain convergence with international accounting standards, the Statement of Financial Accounting Standards No.34 and No.35 were recently issued by the Accounting R&D Foundation (ARDF); as a result the ARDF now claims there are only minor discrepancies between Chinese Taipei GAAP and IAS
- The rules on consolidated financial reporting have been enhanced and a closer scrutiny of financial reporting in general is now required
- Since 2003 both the SFC and the stock exchanges require disclosure on corporate governance matters such as the existence and extent of independent directors on the board
- Also since 2003 the SFC require audit firms to a certain extent to disclose any non-audit activities undertaken by them regarding the companies they audit

125. Policy development in **Thailand** on this priority has made significant progress:

- The Thai Accounting Standards (TAS), which are issued by the Institute of Certified Accountants and Auditors of Thailand (ICAAT), are, with a few exceptions, identical to IAS. According to the Account

Act, B.E. 2543, all Thai companies, including listed companies, must use TAS. Non-listed companies, however, are exempted from some of the more complicated standards. The SEC maintains a list of approved external auditors who are authorized to provide external auditing for listed companies to assure that companies use only capable and trustworthy auditors. The National Corporate Governance Committee (NCGC) in its September 2005 meeting has announced that the TAS will be fully consistent with the International Financial Reporting Standards (IFRS) by the year 2006. At the present, out of 36 TAS, 29 standards are consistent with the IFRS, and 6 are in the drafting process. All Thai companies are required to follow TAS.

- To raise the Thai accounting standards to be on a par with internationally accepted accounting standards, the SEC and the Federation of Accounting Professions agreed to adopt the IFRS as the accounting framework for all companies in the Thai capital market. In this connection, to ensure practicality and prevent undesirable impact, a working group comprising industry experts was set up to explore strategy in adopting the IFRS and guidelines for exemption from IFRS as deemed appropriate
- On October 23, 2004, the "Accounting Profession Act B.E. 2547" was put into effect as another advanced step in enhancing the quality of financial reports. This Act has repealed the Auditor Act B.E. 2505 that regulated only auditors, to regulate the conduct of all accounting professionals thereby accommodating rapid change in current accounting professions as well as providing greater transparency and protection to investors and the public
- The new Act introduced a new regulatory framework under which all accounting professionals (i.e. auditing, accounting, managerial accounting, tax-planning, and other accounting services) are supervised by the new self-regulatory body, the "Federation of Accounting Professions"
- In addition, under this Act, another new body named "Accounting Profession Oversight Board" was also set up to regulate the activities of the Federation, endorse Thai accounting standards and rules issued by the Federation, and consider appeals regarding the Federation's orders

126. In **Vietnam** the Ministry of Finance has adopted in 2003 a new accounting framework which uses IAS as its benchmark. Furthermore State Owned Enterprises are now required to have their financial statements audited as part of a state supervising mechanism focusing on SOE performance.

3.3 Obstacles to progress

127. An obstacle to progress in the short term may be the institutional framework. While the regulatory framework does make progress in most Roundtable economies, as set out above, the necessary institutions to properly interpret, translate and implement the international standards are sometimes lacking or do not yet have the necessary resources.

128. Overlap or overkill by specific regulators each overseeing a particular part of compliance may in practice cause unnecessary costs. For the regulators involved, since the regulatory supervision function regarding the same issue will be undertaken more than necessary; and costs for the reviewed companies for making compliance costs twice. Examples can be found in the role of central banks, ministries, securities regulators and stock exchanges in supervising compliance with corporate governance related regulation by a listed, partially state owned bank (which for example does occur in China).

129. Often audit firms associated in a professional body which also supervises the individual auditors as well as their firms. Potential conflicts of interests are obvious. In particular in case the professional body is a self regulating organization which is in charge of quality assurance and permanent education of its members. Independent and objective review of such self-regulatory bodies may be lacking.

130. Similar to one of the obstacles mentioned above for progress of Priority 2, accounting and auditing of listed companies are typically vulnerable to become box ticking exercises of the formally required steps from the rule book rather than complying with the spirit of, and rationale behind, the internationally adopted standards and practices in this field. Consequently such wrong approach and practice may prove a serious obstacle for sustainable improvement of a proper corporate governance framework in Asia.

3.4 Issues for further improvement

131. <u>To close the respective remaining gaps (i) between national applied and internationally agreed accounting standards, and (ii) between national applied and internationally agreed auditing standards</u>.

132. <u>Audit committees for listed companies</u> should become mandatory. Requirements about qualifications and experience of audit committee members should also be clearly formulated, imposed and implemented by policymakers.

133. Periodical rotation of auditors (e.g. every five years) should become the mandatory standard for listed companies.

134. Legislation regarding consolidation of accounts of group companies should be considered.

135. The establishment of independent national standards setting boards for formulation, adoption and oversight of national accounting standards is a priority.

136. Ensure and sustain the quality of accountants and auditors, both internal and external, by imposing both (permanent) professional training programmes and formal accreditation.

137. To improve transparency, the disclosure requirements on non-financial information, including on corporate governance matters, to be disclosed in annual reports of listed companies, should be strengthened.

4. *Priority 4*

Boards of directors must improve their participation in strategic planning, monitoring of internal control systems and independent review of transactions involving managers, controlling shareholders and other insiders

4.1 Progress since 2003

138. There has been a clear trend in the Roundtable economies of introducing independent directors in boards of listed companies. Recent research (April 2005) by the Asian Corporate Governance Association shows that now in each of China, Hong Kong China, India, Indonesia, Malaysia, Philippines, Singapore, Korea, Chinese Taipei (albeit to a limited extent) and Thailand independent directors are required on boards of listed companies. Obviously their role and responsibilities differ largely and in many cases needs to be further defined. However, it is evident that independent directors are becoming key players in the Asian corporate governance landscape.

4.2 Key developments

139. Although boards of directors in the **Bangladesh** banking and financial services industry indeed have become more pro-active, boards in other listed companies have not made so much progress on this issue. In 2004 the Securities and Exchange Commission (SEC) proposed guidelines for election and appointment of directors and their qualifications with a view to improving corporate governance. In a 2003 study by the Bangladesh Enterprise Institute the key challenges were formulated as follows: (i) a problem with regard to boards is holding and attending board meetings; to provide shareholders with information about the board’s activities, it was recommended that required disclosures should include the dates of board meetings, the attendance records of directors, the director’s individual shareholdings, and changes in director shareholdings; (ii) boards are usually dominated by a family group or sponsors and shareholders do not want these sponsors to reduce their holdings; this makes it difficult to implement good corporate governance principles; (iii) the large size of boards in Bangladesh; it was recommended that boards be limited to ten members; (iv) although independent directors were thought to be important, there were concerns that an independent director can easily become marginalized on a board dominated by executive directors. Until

now independent directors are not common in Bangladesh, also because there is no regulation yet on this issue. Furthermore, although the private initiated Corporate Governance Code, which provides for several guidelines on board practices and directors, was issued in 2004 the adoption on a comply-or-explain basis has yet to be made a requirement under any corporate governance regulation; the SEC has made public that it is currently considering this issue. And, although the practice of "shadow directorships" is quite common within banks due to restrictions on the tenure and the number of directors, no attribution rules to impose fiduciary duties and liabilities on them have been framed yet.

140. Although, due to the complicated share structure of listed companies in **China**, little progress has been made, regulators, and in particular the CSRC actively encourage this priority. The *CSRC Guidelines on Independent Directors (August 2001)* require each listed company to have at least one-third of the board to be independent by June 2003, in order to overcome the "insider control" problem in many of China's listed companies. Independent directors are required to serve as chairs of each of audit, compensation, and nomination committees and also major related-party transactions of the company have to be approved by them. A recent survey of independent directors of listed companies shows that, as of December 2004, 4,681 independent directors had been appointed at shareholder meetings of the 1,377 listed companies in China. Most companies have at least one-third of the board as independent directors. This proves the increasingly important role of independent directors in developing corporate governance in China. Furthermore, in order to tighten the supervision on directors, supervisors and senior officers, the CSRC December 2004 Provisions (as described hereinafter) propose to set up track records of all corporate directors, supervisory directors and senior officers of listed companies, and those who have failed to perform their duties of good faith may be recorded and even banned from serving as directors and / or officers of public companies. Since the end of 2004 indeed independent directors seem to be more explicit and willing to express their opinion, rather then just resigning from the board in case they disagree. Also the Shanghai Stock Exchange in 2005 issued a draft Code of Conduct for Board Chairmen which aims amongst others to reinforce disclosure requirements and to strengthen the board's responsibilities.

In relation to Priority 4 of the White Paper hereinafter a selection of corporate governance related issues of each of the new Securities Law and Company Law (which have both been adopted on 27 October 2005 to become effective as per 1 January 2006), are described. The new Securities Law, amongst others, aims to improve corporate governance. In case of misleading information and omissions in prospectuses, financial statements and periodic reports the Securities Law now imposes liability on each of the issuer, its controlling shareholders, directors, supervisors and senior managers. Sponsor and securities intermediaries may also be held jointly liable. The Securities Law also requires both directors and senior managers to provide written confirmation letters regarding a company's periodic report; in addition the board of supervisors must issue a written opinion in respect of such report. The concept of civil liability for insider trading, market manipulation, misrepresentation and fraud has also been introduced. Furthermore the liability of controlling shareholders, securities companies and senior managers is extended under the new Securities Law. The new Company Law introduces rules, relevant to directors, on the treatment of conflicts of interests. A controlling shareholder, effective controller, director, or senior manager of a company will incur personal liability when taking advantage of a relationship with a third party which damages the interests of the company. Also directors of listed companies are now ineligible to vote on matters in which they have an interest.

141. The new **Hong Kong** Code on Corporate Governance Practices provides principles for the boards of directors of listed companies in directing and supervising company affairs as well as for ensuring that listed companies maintain sound and effective internal controls. In addition, requirements that all related party transactions above a certain threshold must obtain prior shareholder approval, and that a committee of independent directors must advise shareholders on all such transactions, have been in place for some time. The new Code has reinforced the arrangements needed for effective boards. The Code also reinforces the expectation that directors should ensure that they give sufficient time and attention to the affairs of the listed company and should not accept an appointment if unable to do so. In addition, the new Code has helped to codify the expectations regarding independent directors.

142. In **India** the Company Law Committee chaired by Dr. J.J. Irani in its 2005 report has proposed a number of recommendations in this field:

- The Company Act should be revised to include basic fiduciary duties of directors, including (a) duty of care and diligence, (b) exercise of powers in good faith, i.e., discharge of duties in the best interest of the company, no improper use of position and information to gain an advantage for themselves or someone else; and (c) duty to have regard to the interest of employees
- The Company Act should recognize the principle of independent directors and spell out their role, qualifications and liabilities
- Voluntary or "comply-and-explain" codes of conduct for directors should be developed by industry associations

Furthermore the government is considering to limit the number of directorships that one person can have in order for directors to spend productive time and energy on the directorships they hold. Currently listed companies are required to lay down procedures for risk assessment and minimisation and the same need to be submitted to board members for their periodic review. Also audit committees, consisting of two third independent directors, are entrusted with the responsibility of reviewing significant 'related party transactions'.

143. In **Indonesia** the introduction of regulations regarding independent commissioners is expected to have a positive impact on the participation of directors in board work. The two-tier board system is perceived by some market participants as an obstacle to progress on this topic. Indonesian Institute for Corporate Directorship (IICD) selected activities since its inception on November 22, 2000. IICD disseminated GCG (Good Corporate Governance) through 30 seminars for directors (Professional Director Program started in 2003).

144. In **Malaysia** this priority had been already covered in the 2000 Code of Corporate Governance. Under the Bursa Securities Listing Requirements, listed companies are required to disclose the extent of compliance with the Code on a comply or explain basis in their annual reports. In addition, Bursa Securities Listing Requirements contain stringent provisions in relation to related party transactions which involve the interests of directors, major shareholders or parties connected to them.

145. In **Pakistan** the frequency of board meetings has increased since 2002. In compliance with the law in most listed companies there are now board meetings on a quarterly basis with clear meeting agendas distributed well in advance. In a study on the impact assessment of the Code of Corporate Governance, it has been found that in a sample of around 40 companies, all companies stated that the Board of Directors had formulated a corporate strategy and policies to ensure implementation of an effective system of internal control. All the companies also declared that complete records of implementation of the policies are being maintained. However, this did not stop the Securities and Exchange Commission of Pakistan (SECP) recently from taking action to verify compliance. The Enforcement department of the SECP found 34 companies violating the relevant rules during the month of March 2005 and took action against them accordingly. In its efforts to effectively monitor and regulate the corporate sector, the SECP has started referring different cases of defaults/irregularities of directors and management of companies to the courts of law in order to strengthen the discipline of the directors. In September 2005, a court decision to convict and punish the offending director (of textile company) for non-filing of the company's annual

accounts and non-compliance with statutory requirements, being the first instance since establishment of the SECP in 1999, represents a major landmark in the drive to enforce corporate laws and make director law abiding as well as proactive.

In September 2003, the *Hand Book on Corporate Governance* was published; the main objective of this Handbook is to provide guidance to the members of the board of directors and the management of banks for promoting good corporate governance in their institutions – it contains International Best Practices and the State Bank of Pakistan's instructions on the subject.

146. This priority is mandated under the **Philippines** Code of Corporate Governance issued by the SEC as well as in the Corporation Code (act). In addition separate circulars by different regulators emphasize the importance, i.e. the Central Bank, the Insurance Commission and the Energy Regulatory Commission. The required improvement on board of directors' participation in strategic planning, monitoring of internal control systems and independent review of transactions involving managers, controlling shareholders and other insiders, have been mandated through the creation of separate committees**,** i.e., nomination, compensation and audit committee. Each committee is composed of at least three directors, one of whom is an independent director. A certification from a Compliance Officer is required to be submitted annually. Said certification indicates any deviation by any director from the foregoing responsibility. Moreover, the company's Corporate Secretary is required to submit annually a certification indicating the number of board meetings conducted during the fiscal year and the attendance and absences of each director. Major findings in a company's audited financial statements are required to be taken up by the members of the audit committee and are elevated to the board. Board actions on said findings are required to be submitted to the SEC. Importantly, the SEC has now incorporated in its operational procedures the monitoring of compliance with the foregoing responsibilities.

147. In **Singapore** the revised Code of Corporate Governance which came into effect last 14 July 2005, deals extensively with this issue. Since listed companies have to disclose their compliance, on a 'comply-or-explain' basis, with the Code to the annual general meeting shareholders since 1 January 2003, progress has been made on implementation of this priority.

148. On 26 May 2004 the **Chinese Taipei** legislator adopted the "Proposal for an Independent Directors and Independent Supervisors Election System", the mandatory "Procedure for electing Directors and Supervisors," the

"Rules Governing the Conduct of Shareholders Meetings," and "Organization Rules for Directors and Supervisors Nomination Committee". Pursuant to the "Review of Qualification and Independence for Independent Directors and Supervisors" the FSC promulgated the qualification rules for independent directors and supervisors on September 23 2003. The independence rules for independent directors and supervisors of the subsidiaries of a financial holding company were under discussion and an interpretational ruling thereon was made on 8 June 2004.

149. Although currently in **Thailand** many directors may still not fully understand the scope of their role and responsibilities, the introduction of the Director and Management Registration System is the policy measure introduced to tackle this concern. Moreover, the Institute of Director (IOD) director courses have proved to be successful in terms of number of participants. Currently, there are 2,300 participants participated in the Directors Certification Program and the Directors Accreditation Program. Now 99% of listed companies have directors attending one of the IOD courses.

Since 2004, the SEC requires listed companies to disclose their own criteria of independent director *above* the minimum requirement set out by the SEC and the SET. Such minimum requirement includes the presence of at least 3 independent directors in their board of directors. To guide the listed companies in this regard, the SEC has issued a guideline regarding the qualifications of independent director.

The role of audit committees has been re-emphasized; the audit committee is now responsible for to ensure that the systems for accounting and financial reporting, including independent audit and control are adequate. The audit committee is also expected to provide recommendations to the board of directors if necessary actions are needed to taken. Since early 2003, pursuant to the annual registration statement, the SEC requires that the managing directors and the CFO certify whether the internal control of the company is adequate and effective. The company shall also disclose information regarding internal controls in an annual report which shall include an opinion of the Board of Directors on the adequacy of the internal control system, and whether it is protected against the inappropriate or unauthorized use of its assets by its management. In the case that the audit committee has a different opinion from the Board of Directors or the auditor has any observations regarding the internal control system, such opinion or observations shall be included in an annual report. Moreover, the company shall also include the report of the audit committee with respect to good corporate governance as an attachment to an annual report.

Furthermore, in December 2004, the SEC laid down its 2005 Action Plan focusing on the improvement of good corporate governance of Thai listed companies on par with international standards. Examples of actions included are:

- building up better understanding among practitioners by introducing a "Director's Handbook" that clearly prescribes roles and responsibilities of directors under the Thai law and in accordance with best international practices, and by encouraging listed company directors to participate in the training courses organized by the Thai Institute of Directors Association (IOD); and
- adopting a registration system for listed company directors and management, which will take effect from March 1, 2005, for the purpose of monitoring as well as imposing administrative sanctions

150. In **Vietnam** the recently adopted Unified Enterprise Law (UEL) clarifies the obligations of directors and board members; particular focus has been given to the three key fiduciary duties of directors and board members, i.e. loyalty, honesty and prudence. Furthermore the UEL contain guidelines on disclosure and transparency to be complied with by management. The UEL also contains provisions regarding the delineation of responsibilities between shareholders and management as well as remuneration of board members and directors of joint stock companies.

4.3 Obstacles to progress

151. Board meeting attendance which should be one of the first priorities for any board member is often low.

152. Boards in Asia are often dominated by families or other controlling shareholders; this makes it difficult to improve corporate governance since the will for such improvement is not apparent.

153. The large size of board in practice makes efficient decision making processes difficult.

154. The independence of formal "independent" directors is sometimes questionable. This may be due to ambiguous definitions in regulation regarding independent directors.

155. The practice in groups of companies of appointing directors and board members to the different group companies makes compliance with fiduciary duties by such directors difficult, if not impossible.

4.4 Issues for further improvement

156. Defining the fiduciary duties of directors and board members in the company law should be considered.

157. Strengthening civil enforcement options for investors by introducing legislation to facilitate derivative suits against individual directors for breach of their fiduciary duties.

158. Limit the number of board memberships to a maximum to ensure that individual directors indeed devote the necessary time to boards in which they have a seat.

159. Promote compliance by individual directors and board members with best practices formulated in corporate governance codes.

5. *Priority 5*

The legal and regulatory framework should ensure that non-controlling shareholders are protected from exploitation by insiders and controlling shareholders

5.1 Progress since 2003

160. This Priority has been forwarded in many Asian Roundtable economies, in particular through the introduction of new policies on three topics, i.e. class actions, independent directors and proxy voting. Each of China, Hong Kong China, Korea, Malaysia and Chinese Taipei have introduced legislation to promote civil enforcement through different forms of class actions and in some cases derivative suits. Also much attention has been paid to the role of independent directors in safeguarding the interests of non-controlling shareholders. Although this is a complicated topic in which much discussion has focused on the definition of 'independent director' in itself such debate underlines the potential important role to be played by these relative new members to boards of directors in Asia. Finally, policymakers in some Asian countries (in particular China, Malaysia, Pakistan and the Philippines) have been focusing on how to streamline the voting process and to ensure that all shareholders can effectively make use of their voting rights; proxy voting mechanisms have been put in place and will have to prove themselves in the years to come.

5.2 Key developments

161. In **Bangladesh** an important concern remains the dominant role of the state as shareholder since the state does not (always) properly and consistently exercises its shareholder rights, which in the end may be to the detriment of the other (non-controlling) shareholders. Another obstacle for strengthening shareholder protection is the lack of possibilities to properly identify beneficial owners. Although the establishment of the Central Depository was expected to improve owner identification transparency, it has been recently detected that there has been thousands of fictitious accounts opened with the system. The SEC is in the process of upgrading the system. Furthermore, institutional investors do not make sufficiently use of their powers as block shareholders amongst others because of a proxy voting regulation that does not properly facilitate proxy voting. Consequently the level of monitoring of the functioning of the board by institutional investors is not

what it could (or should) be. Finally, there is not yet specific legislation regarding class actions or derivative suits which limit shareholders options to enforce their rights. Also the high costs involved in any litigation prevent or even frustrate collective shareholders action.

162. In **China** recently the following initiatives have been taken by policymakers:

- To better protect the rights and interests of public investors, the CSRC in December 2004 issued the *Provisions on Strengthening the Protection of Rights & Interests of Public Shareholders*, pursuant to which listed companies' major business decisions, such as rights issues and issuing additional new shares, and equity-for-debt plans, now need a majority votes from holders of tradable-shares present in the general shareholders meeting

- Because of China's geographical location it is often difficult for investors to attend shareholders meetings in person. Therefore, the *Provisions* require listed companies to provide online voting platforms for shareholders' meeting. Since the promulgation of the Provision in December 2004, more than 20 listed companies have provided on-line voting platforms for their shareholders during their shareholder meetings and the results so far are satisfactory

- In 2003, the Chinese People's Supreme Court released a new ordinance that enables the shareholders, who have suffered from investment losses resulted from false information disclosure by listed companies, to take legal actions against the directors and senior officers of the company. Investors may claim for civil compensation according to the 2003 ordinance

- Historically, about two-thirds of Chinese shares are owned by either the state or by legal entities and are non-tradable. The interests of shareholders of these non-tradable shares are sometimes different from those of tradable shares, especially on issues such as issuing new shares and dividend payment. This has become a serious institutional barrier for further developing capital markets. Therefore the CSRC issued a *Circular on the Pilot Reform of Share Tradability of Listed Companies* on April 29, 2005 which aims to reform the present structure of non-tradable shares. According to the regulation, each company on the pilot program shall work out a plan for floating, and submit to shareholder meetings for approval. To protect the rights and interests of public shareholders, the regulation stipulates that the plan shall not only pass the general shareholder meeting by two-thirds of votes, but also be agreed by two-thirds of shareholders of floating shareholders. It also set the limits for the proportion of shares that can be floated in the following three years. Now, the pilot companies have implemented the reforms and all other companies have started the process of reform

- With the establishment of the State Asset Supervision and Administration Commission (SASAC) in 2003 the state has embarked on a programme to strengthen its shareholder function and actively pursue its institutional investor's role in some of the largest listed companies
- In order to improve the responsibilities of institutional shareholders in corporate governance of listed companies the CSRC also issued the "Statement on Institutional Shareholder Responsibilities" in February 2004; this will have in particular implications for SASAC in its position of institutional shareholder in the listed SOEs
- SASAC has started establishing boards in large state owned enterprises and also started recruiting CEOs and senior management from abroad for these companies

Both the new Company Law and Securities Law contain important sections dealing with the position of non-controlling shareholders. The Securities Law contains a more general provision which prescribes that an investor protection fund is to be set up (the details about how this will be brought into practice are yet to be published). Moreover the new Securities Law now provides for a civil compensation system. Parties found to be guilty of committing insider trading, market manipulation, misrepresentation and fraud will have to bear the loss suffered by an investor or a client.

The new Company Law sets out detailed provisions dealing with the protection of non-controlling shareholders' rights. Amongst others, shareholders holding at least three per cent of the company's shares may put forward proposals to the board of directors. Shareholders also may require the company to repurchase their shareholding when they oppose (i) the acquisition or the merger of the company or a disposal of the company's major assets, or (ii) the company's decision not to distribute profits for five consecutive years despite having been profitable for those years. Civil enforcement options for shareholders are further strengthened now that they are entitled to bring actions against directors, supervisors and/or senior managers for violation of any law, regulation, or the company's articles of association. Also, shareholders holding at least ten per cent of the company's shares have the right to petition the People's Court to liquidate the company when the company's managerial problems threaten to damage shareholders' interests.

The Company Law also substantially changes the existing voting mechanisms in companies. The articles of association of any limited liability company may now allocate voting rights between shareholders in proportions different from their respective contributions. In addition shareholders may receive dividends and/or enjoy priority subscription for new equity in proportions different from their capital contribution ratios. The Company Law also permits cumulative voting system at shareholders meetings for the appointment of directors. Moreover the appointment mechanism of the chairman and vice-chairman of the board of directors shall now be specified in the articles of association.

The Company Law provides tools for shareholders to exercise supervision over the company. Shareholders now have the right to view and copy (i) the company's articles of association, (ii) financial reports and (iii) board meeting minutes, and are also entitled to consult the company's accounting books. Within sixty days after a shareholders' or board of directors' resolution is made, a shareholder may petition the People's Court to revoke the resolution if it breaches the company's articles of association.

163. In **Hong Kong China**, all related party transactions above a certain threshold require prior shareholder approval. Proposals to give the SFC responsibility for enforcing rules over certain transactions requiring shareholder approval will strengthen the regulatory oversight in this area. The Hong Kong China authorities are currently considering the merits of class actions in general as part of an overall review of the judicial system. In addition, legislation to provide for statutory derivative actions by shareholders took effect in 2005.

164. In **India** this priority has been discussed by different corporate governance committees. In early 2000, the SEBI board had accepted and ratified key recommendations of the Kumar Mangalam Birla committee, and these were incorporated into Clause 49 of the Listing Agreement of the Stock Exchanges. Subsequently the Naresh Chandra committee was appointed in August 2002 by the Department of Company Affairs (DCA) under the Ministry of Finance and Company Affairs to examine various corporate governance issues. The Committee submitted its report in December 2002. It made recommendations in two key aspects of corporate governance: financial and non-financial disclosures; and independent auditing and board oversight of management. The fourth initiative on corporate governance in India is in the form of the recommendations of the Narayana Murthy committee. This committee was set up by SEBI to review Clause 49, and suggest measures to improve corporate governance standards. Some of the major recommendations of the committee primarily related to audit committees, audit reports,

independent directors, related party transactions, risk management, directorships and director compensation, codes of conduct and financial disclosure. And recently the Company Law Committee chaired by Dr. J.J. Irani in its 2005 report has proposed to amend the Company Act to formally recognize the concept of independent directors and spell out their role, qualifications and liabilities. Although listed companies may now already opt to protect minority shareholders' interests through the use of independent directors, it is anticipated that in particular non-controlling shareholders will benefit from the formal introduction of independent directors.

165. The **Indonesian** Society of Investors (MISSI) actively promotes protection for minority shareholders. Recently MISSI together with institutional investors such as the Insurance Council of Indonesia and the Indonesian Pension Fund Association set up a joint organisation called Investor Advocacy, Protection and Proxy Institution. The introduction of regulations regarding the role of independent commissioners (supervisory directors which execute the monitoring/supervision of the managing directors in Indonesia's two tier board structure) are intended to strengthen the position of non-controlling shareholders.

166. In January 2005 the **Korean** class action lawsuit legislation came into force (adopted in 2003); this allows for shareholders to undertake class actions regarding alleged false disclosure, window dressing and insider trading (including stock price manipulation).

167. In **Malaysia** the Finance Committee Report on Corporate Governance recommended that voting by mail be allowed by the Companies Act and that relevant regulators should study the current regulatory framework of proxy rules to identify any improvement opportunities. The Government in December 2003 established the Corporate Law Reform Committee (CLRC) to carry out its long-term plan in the corporate law reform programme. The objective of this programme is to enable corporate and business activities in Malaysia to function in a cost effective, consistent, transparent and competitive business environment whilst balancing obligations, responsibilities and protection of corporate participants in line with international standards of good corporate governance. The review will also take into consideration the needs of the domestic business environment, global and international standards. CLRC is currently reviewing inter alia issues such as proxy regulations, company voting process and voting in absentia. This review is currently undertaken by one of the five working groups under the auspices of the CLRC with the focus on enhancing corporate governance through corporate law reforms. The Finance Committee Report also made recommendations pertaining to the introduction of a derivative action in statutory form. Additionally the

same report recommends the examination of whether statutory provision(s) should be introduced to simplify civil procedures and to permit shareholders to undertake representative/class actions to obtain a pro-rata share of damages. The Finance Committee Report has also identified the introduction of cumulative voting for election of directors as an additional initiative that needs to be considered. Some of these issues are currently being considered and examined by the Companies Commission of Malaysia or CLRC as part of the corporate law reform exercise.

168. In **Pakistan**, the Listed Companies (Substantial Acquisition of Voting Shares and Takeovers) Ordinance, 2002 has been promulgated to provide for fair and equal treatment of all investors as well as a transparent and efficient system for substantial acquisition of voting shares and takeovers of listed companies. These objectives are met by the requirement that persons acquiring more than 10 percent of the voting shares in a listed company must disclose this information to the said company and to the concerned stock exchange. Similarly, a person who intends to acquire more than 25 percent voting shares has to make a public announcement of his offer and send an offer letter to all the shareholders of the company. This practice, though required by law, is met mostly in letter and not so much in the spirit. More in general shareholders in Pakistan are being encouraged to particpate in meetings. The information regarding shareholders meetings is now circulated well in advance thorugh mail and newspapers notices. The board of directors sends proxy forms to the shareholders. This proxy form allows for two-way voting on all resolutions which are to be proposed i.e. shareholders has the choice to vote for or against any resolution. If a shareholder does not specify how the proxy should vote on the different issues, the proxy will be free to vote as he pleases.

169. In the **Philippines** various regulations have been issued to ensure that non-controlling shareholders are protected from exploitation by insiders and controlling shareholders. Section 38 of the Securities Regulation Code ("Code") requires listed issuers of securities to the public and public companies to have at least two (2) independent directors or such independent directors shall constitute at least twenty percent (20%) of the members of such board, whichever is the lesser. Such independent director is a person other than an officer or employee of the corporation, its parent or subsidiaries, or any other individual having a relationship with the corporation, which would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. The Amended SRC Rule 38 ensures that qualified independent directors are nominated and elected. The mandatory tender offer under Section 19

of the Code is intended to protect minority shareholders. In case of a change in control or sale of at least 35% of the outstanding capital stock of a listed or public company from one majority stockholder to another person, such purchaser must offer all other remaining stockholders with the same price and consideration as that offered to the selling majority stockholder. The full disclosure policy of making available to the public all relevant and material information about the company and its activities is likewise mandated under the Code to protect non-controlling shareholders. Furthermore the SEC issued a Circular in April 2004 requiring audit committees to be composed of at least two independent directors, one of whom should be the chair.

The SEC issued SRC Rule 20 which requires that means shall be provided in the proxy form whereby the person solicited is afforded an opportunity to specify a choice between approval or disapproval of, or abstention with respect to each separate matter referred to therein as intended to be acted upon, other than election to office. A proxy may confer discretionary authority with respect to matters as to which the security holder does not specify a choice, provided that the form of proxy states in boldface type how it is intended to vote the shares represented by the proxy in each such case. The integrity of the voting process has been strengthened with the required disclosure in the information statements to be distributed to stockholders, of the manner the voting shall be conducted and how the votes shall be counted. The Rules contain specific guidelines on proxy voting. Also, the SEC may send its representatives/observers to stockholders' meetings under such terms and conditions it deems appropriate.

170. Regarding insider stock transactions in **Chinese Taipei**, the FSC requires all public companies to comply with the following steps: (i) pre-filing, (ii) *ex post* fact filing, and (iii) pledge contract filing. Also, the requirements on filings by insiders of financial institutions in mergers and acquisitions transactions have been strengthened. In 2003 the Investor Protection Law came into force. This law authorized the establishment of the Investor Protection Center. This Center may be empowered to act on behalf of groups of shareholders in a special kind of class actions (or class arbitration). Up to May 2005, 41 class action lawsuits have been filed by the Investor Protection Center. A total of 20,351 investors have registered to participate in these suits, and compensation of NT$11.39 billion has been paid out. In addition, according to Article 41 of the "Code of Civil Procedure", persons who are involved in the same issue and share a common interest may select one or more persons from among themselves to act as a procurator in the case. Moreover, the regulator has urged boards to be more involved by signing on each of

audit control report, affiliated person transactions review and merger proposals. Finally it is intended to give shareholders the right to sponsor proposals in the annual general meeting of shareholders.

171. In 2004, the related party transactions regulation in **Thailand** was revised to be more precise and more effective in providing protection to minority shareholders. The headlines of the regulation are:

- the notice requirement for the submission of the meeting agenda is extended to 14 days prior to meeting date
- financial assistance transactions with a minimum value of 100 million Baht now require prior shareholders' approval
- under certain circumstances, the Stock Exchange of Thailand (SET) may require listed companies to permit a SET inspector to attend and supervise / monitor the shareholder's meeting to ensure compliance with relevant rules and regulations

Proposed amendments to the securities legislation are meant to increase the protection of minority shareholders. For example, the new securities act will allow the SEC to specify the notice period to inform shareholders of upcoming shareholders' meetings. Furthermore, the proposed amendment to the securities act would entitle shareholders representing 5% of the total issued share capital of the company to request that the board include matters proposed by them to the agenda of the shareholders meeting, provided such request is submitted, in the case of the annual general meeting, within 70 days following the end of the fiscal year, and, in the case of an extraordinary general meeting, within 14 days following the date of the board's approval to convene the meeting. Should the company fail to do as requested, it would be required to give detailed reasons in the notice of meeting, and the shareholders would still have the right to have their items added into the agenda of the next meeting, upon their majority vote. Moreover, the proposed amendment to the Public Company act will reduce the threshold required for shareholders to convene a shareholders meeting to 10% of the total number of votes of shareholders. Furthermore, a draft Class Action Act, has been proposed. The new law will enable shareholders and investors to sue directors, managers, auditors and relevant parties for breach of their duties more easily and with much less concern about the costs. The SEC also intends to urge the widely use of cumulative voting for listed companies. Also, the SET has adopted Best Practices for Shareholders which amongst others are intended to protect the interests of non-controlling shareholders.

172. Non-controlling shareholders in **Vietnam** are entitled to receive information about the company. The new UEL contains provisions that better protect the intersts of non-controlling shareholders, as well as creditors. The UEL further covers a number of issues in the management of converted SOEs, such as the lack of clear-cut rights and responsibilities between the owners and the management, the dual roles of ministries and complicated mechanisms for personnel recruitment and appointments Furthermore the adoption of the Bankruptcy Law may improve the exit options for non-controlling shareholders.

5.3 Obstacles to progress

173. Opaque structures for groups of companies restrict transparency often to the benefit of one or a few controlling (minority) shareholder and thus to the detriment of non-controlling shareholders. The need for policy reforms in order to make such opaque ownership structures comply with good corporate governance standards, seems obvious but remains often difficult to achieve due to political considerations.

174. In general, ownership structures in Asian listed companies whereby the controlling shareholder is a family or the state may often create problems for non-controlling shareholders to properly effectuate their shareholders rights.

175. Existing legislation and regulation may restrict the monitoring role of non-controlling shareholders and their options of exercising control. Because of weak incentives shareholder activism is lacking, even by institutional investors.

5.4 Issues for further improvement

176. Introduction of class action and derivative suits in legislation in order to stimulate civil enforcement of good corporate governance through shareholder activism.

177. Considering the important role of controlling shareholders in the Asian economies, introducing incentives in legislation and regulation for controlling shareholders to adhere to good corporate governance practices is important. In particular in the economies with huge, often family owned, groups of companies with one or more listed group company involved, and in those economies where the state still plays a dominant role as shareholder in listed companies.

178. Mandatory disclosure of underlying shareholdings by directors and board members and / or holding companies will increase transparency.

179. Similar to that, mandatory disclosure of interlocking shareholdings (via cross shareholdings and pyramid structures) will increase in particular corporate governance level of groups of companies.

180. Introduce or strengthen insider trading legislation to cover both transactions among insiders and trading in the company's shares by board members having non public knowledge or information.

6. *Priority 6*

Governments should intensify their efforts to improve the regulation and corporate governance of banks

6.1 Progress since 2003

181. Modern doctrine on financial supervision relies on three factors for bank regulation: (i) the bank's internal governance; (ii) surveillance by the market of the banks, and (iii) official banking supervision. Although probably not exactly on each of these factors, the majority of Roundtable economies indeed has made progress regarding this priority. Most of the efforts focused on the banks' internal governance. And in some economies also efforts have been undertaken to strengthen the role of the banking regulator.

6.2 Key developments

182. **Bangladesh** Bank (BB, the central bank of Bangladesh) was one of the supporters of the private led initiative of the 2004 Code of Corporate Governance for Bangladesh. Almost corporate governance related reform in Bangladesh has been initiated in the banking sector. As a consequence the legislation and regulation of corporate governance of banks has made significant progress. Amongst others because of the following regulations issued by the BB:

- 23 December 2002, *audit committee of the board*: The audit committee will assist the board in fulfilling its oversight responsibilities including implementation of the objectives, strategies and overall business plans set by the board for effective functioning of the bank. The committee will review the financial reporting process, the system of internal control and management of financial risks, the audit process, and the bank's process for monitoring compliance with laws and regulations and its own code of business conduct
- 16 March 2003, *fit and proper test CEOs*: detailed regulation and criteria regarding (i) moral Integrity; (ii) experience and suitability; and (iii) transparency and financial integrity
- 26 April 2003, *fit and proper tests for directors*: (a) directors must have management/business or professional experience for at least 10(ten) years; (b) (S)he has not been convicted in any criminal offence

or involved in any fraud/forgery, financial crime or other illegal activities; (c) (S)he has not been subject to any adverse findings in any legal proceedings, (d) (S)he has not been convicted in regard to contravention of rules, regulations or disciplines of the regulatory authorities relating to financial sector; (e) (S)he has not been involved with a company/firm whose registration/license has been revoked or cancelled or which has gone into liquidation; (f)Loans taken by him/her or allied concern from any bank or financial institution have not become defaulted; (g) (S)he has not been adjudicated a bankrupt by a court; (h) (S)he must be loyal to the decisions of the board of directors. However, in case of note of dissent, (s)he may record it in the minutes of the board meeting and/or inform BB thereof

- 26 April 2003, *constitution of the board of directors*: (a) restriction has been imposed on the size of bank boards; the maximum number of directors for a bank has been limited to thirteen; (b) close relations, e.g. parents and children, husband and wife, siblings can no longer be directors for the same bank;

- 24 July 2003, *responsibilities and authorities of the board directors*: detailed regulations on (i) Work-planning and strategic management; (ii) Lending and risk management; (iii) Internal control management; (iv) Human resources management and development; (v) Financial management, as well as on (a) Responsibilities of the chairman of the board of directors, (b) Responsibilities of the adviser to the chairman, (c) Responsibilities and authorities of the CEO, and (d) Responsibilities of the adviser to the CEO

- 7 October 2003, G*uidelines on core risks management*: Bangladesh Bank has issued guidelines on five core risk areas of banking- (a) Credit Risks, (b) Asset and Liability /Balance Sheet Risks, (c) Foreign Exchange Risks, (d) Internal Control and Compliance Risks and (e) Money Laundering Risks. Banks have been advised to put in place an effective risk management system based on the guidelines

- 31 December 2003 (effective date), *disclosure requirements*: banks are required to disclose more information in their financial statements as per IAS as of the financial year 2003, through amendments in the Bank Companies Act, 1991. The formats of Balance Sheet and Profit and loss Account were revised to provide more transparency and banks are now to disclose key business ratios. It is aimed at providing investors, depositors and other stakeholders with transparent and adequate information on financial health of banks. Further extensive disclosure requirements are adopted, amongst others on related party transactions and large borrowers

- 30 June 2004, *Guidelines on Core Risks Management*

In addition the Ministry of Finance on 10 March 2003 issued regulations regarding the constitution of the board of directors of banks, in summary: (i) no person can remain a director in a bank for more than six years. A director who loses his/her directorship will have to wait for one term, normally three years, before he/she becomes eligible to seek election as a director again; and (ii) BB has the authority to appoint up to two directors at a bank's board to protect the interest of the depositors.

183. In 2003 the process of bank reform in **China** advanced considerably when the Sixteenth Congress of the Communist Party endorsed accelerated efforts to restructure the banking system. Reforms had to address issues such as the ownership of the bank, the incentives of the bank's owners and managers, the market signals which the banks receive and the degree of competition in the market. In the past two years the authorities have developed a policy for banks with the following key elements:

- A reform of ownership structures of banks in order to find owners capable of monitoring bank performance effectively
- Upgrading supervisory of banking practices in line with international norms
- A strengthening of the legal and regulatory framework for bank governance
- Increased transparency and increased exposure of Chinese banks to scrutiny by the market
- An expanded foreign presence in the banking system partly linked to Chinese WTO membership and partly linked to a desire to benefit from foreign competition

These measures apply to all banks. Simultaneously, a special program for the state-owned commercial banks (SOCB) sector in which two "pilot" SOCBs have been subjected to radical restructuring and in which access to public funds will be conditional upon reforms undertaken by the banks. With the decision to accelerate banking reform in 2003, supervisory responsibility was transferred to the newly formed China Banking Regulatory Commission (CBRC). The CBRC is now attempting to align its domestic activities with best international practices. Since late 2003, the CBRC has been articulating a strategy to reform the banking system based upon accelerated introduction of market based principles of corporate governance in the banks as well as special programmes to rehabilitate the SOCBs. In respect of the pilot project CBRC issued on 11 March 2004 the *Guidelines on Corporate Governance Reforms And Supervision of Bank of China and Construction Bank of China*. The main instruments affecting the corporate governance framework for banks are currently (i) the Company Law; (ii) the Banking Law; (iii) the Law of the People's Republic of China on Banking Regulation and Supervision of 27 December 2003 (iv) the Guidance on Corporate Governance for Joint Stock Commercial Banks; and (v) the Code of Corporate Governance for Listed Companies (CCGLC). The Company Law and the CCGLC apply to financial and non financial companies, but the other instruments only apply to banks. In particular the Banking Law of 1994 after its amendment in 2003 contains many provisions concerning the corporate governance of banks such as the role of various organs of the company and the requirements regarding transparency and disclosure. Furthermore, to evaluate commercial banks' internal control processes CBRC on 25 December 2004 the *Provisional Rules for Internal Control Evaluation of Commercial Banks* (which came into force on 1 February 2005). As mentioned above the CBRC has been taking a proactive role to have commercial banks, in particular SOCBs, to improve their corporate governance. In relation thereto the CBRC has been assessing on a quarterly basis since the end of 2003, the progress made by corporate governance reforming banks as well as their financial performance. The CBRC also strongly encourages reforming banks to introduce foreign strategic investors, amongst others since it is expected that these foreign strategic investors will play a catalyst role in urging banks to improve their corporate governance.

Moreover, in September 2005 the CBRC issued the *Guidance on Functioning of Board of Directors in Joint Stock Commercial Banks*; the guidance imposes certain objectives for boards of directors, including the improvement of the structure of the board (through independent directors and specialized committees), and the establishment of good working mechanisms and well functioning decision-making and monitoring processes. The Guidance also states that boards have to work in good faith and diligence, taking into consideration the interests of depositors and other stakeholders as well as that of shareholders; that they should work independently (independently from the shareholders and senior management), objectively and just, on the basis of sufficient information, and work professionally and efficiently with qualified employees and in accordance with proper procedures. Moreover, the board will have to ensure high ethical standards and a good corporate culture.

Finally, in December 2005, the CBRC established the supervisory rating system for commercial banks in China, named "CAMELS+", which provides more incentive for banks to enhance their corporate governance. Pursuant to the "CAMELS+" system, the banks' "management" has to assess the quality of corporate governance of a bank, as well as the internal control procedures.

184. In 2001 the **Hong Kong** Monetary Authority (HKMA), the regulator of banks in Hong Kong China, issued requirements for corporate governance of banks that are consistent with the OECD recommendations and guidance from the Basel Committee that specifically relates to banks. The HKMA periodically reviews these requirements in the light of further guidance and developments in international best practice, with the next such review planned for 2006. Moreover the HKMA recently issued the following corporate governance related regulations:

- April 2003, *general risk management control*: the Guideline specifies the general controls which the HKMA expects Authorised Institutions (AIs, which include (a) banks; (b) restricted licence banks; or (c) deposit-taking companies) to have in place in their risk management systems. It covers general controls relating to risk management, appropriate board and senior management oversight, adequate organisational policies and procedures and risk limits, risk measurement function, monitoring and reporting as well as internal controls and audit. It also includes business contingency planning
- November 2003, *reporting requirements relating to external auditors*: the Guideline serves to provide guidance in respect of the reporting obligations of AIs' external auditors under the Banking Ordinance. It summarised auditors' major duties and responsibilities in relation to prudential supervision under the Banking Ordinance
- June 2003, *general principles for technology risk management*: the Guideline provides AIs with guidance on general principles which AIs are expected to consider in managing technology-related risks
- December 2004, s*afe-guarding customers' assets and information*: This circular letter suggests measures that AIs should take in order to minimise their exposure to operational, reputation and security risks

185. The **Indian** Ministry of Finance and the banking sector regulator, the Reserve Bank of India ('RBI'), continue to provide priority to improve corporate governance of banks and financial institutions. Early 2000 the RBI provided some guidelines for 'best practice' corporate governance in the banking sector. In July 2004, the RBI issued draft guidelines on

ownership and governance for the private sector banks. These guidelines are now being finalized subject to public consultation. Some selected corporate governance related issues covered include (i) a requirement that any shareholding of 5 per cent and above must meet a 'fit and proper' test, (ii) no single entity or a group of related entities may hold shares in a bank in excess of 10 per cent of the paid-up capital, (iii) large industrial firms will be permitted to acquire upto a maximum of 10% os the shares in a bank, (iv) any domestic bank's or financial institution's cross share holding is restricted to 5 per cent, (v) foreign banks operating in India are restricted to a shareholding of 5 per cent, (vi) provisions will be introduced in the guidelines (at a later stage) to restrict board membership upto one family member or a close relative or associate, and (vii) continuing compliance of 'fit and proper' criteria for shareholders and directors will have to be ensured by the bank subject to independent verification by RBI. The RBI requires all private sector banks to submit a timeframe for full compliance with the abovementioned requirements. Furthermore the RBI may undertake independent verification of the 'fit and proper' test conducted by the private sector banks.

In general Indian banks and financial institutions have undergone significant changes in the last six years. Consequently, in particular their management style seems to have improved. Large public sector banks are preparing to compete with private sector banks and now need to realise the significance of good governance in the process. The government has adopted a policy of decentralisation regarding state owned enterprises. Excessive control however continues to impact the corporate governance of state owned banks.

186. Since January 2003, Bank **Indonesia**, has issued a number of regulations focussing on banks' compliance with good corporate governance standards, including (ADBI /UFJ/FCGI, 2005):

- Submission of the quarterly and annual financial report to Bank Indonesia (circular letter No. 3/30-31/2003)
- Enhancing the competence and integrity of bankers by imposing a Fit and Proper Test on each bank's shareholders and management (BI regulation No. 5/25/2003)
- Strengthening Bank Indonesia's supervisory function and the status of the Bank (BI regulation No. 6/9/2004)
- Maintaining consistent law enforcement by establishing a Banking Investigation Special Unit, to uncover violations against banking rules

- Implementation of Know Your Customer Principle (BI regulation No 5/21/2003)
- Application of risk management for commercial banks (BI regulation No. 5/8/2003)
- Application of risk management for transaction through Internet (BI regulation No. 6/18/2004)

Furthermore, in 2004, Bank Indonesia published "The Indonesian Banking Architecture", a basic framework for the Indonesian banking system which sets forth the direction, outline, and working structures for the banking sector over the next five to ten years. One of the six pillars of the Architecture is to build good corporate governance for internal strengthening of the banking sector. Thereto minimum standards for good corporate governance will be established. In addition the National Committee on Corporate Governance issued the Indonesian Banking Sector Code in 2004. According to the Banking Code, good corporate governance has five essential elements: fairness, transparency, accountability, responsibility, and independence.

187. **Korea.** In a recent study by ADBI (ADBI / Jae-Ha Park Korea Institute of Finance, May 2005) it is argued that since its inception six years ago the financial sector supervisory system is generally considered to be successful in accomplishing the objectives of the restructuring process after the financial crisis and introduced global standards in the supervisory and regulatory system. However, the relationship between the FSC (which is the steering commission of the FSS, whereby the chairman of the FSC is also the chairman of the FSS) and the FSS has not always been working as efficiently as expected. Besides, the FTC also has an important role as supervisor of the *chaebols* (large groups of companies). Consequently *administrative enforcement* may be strengthened. The problems became evident through a series of serious financial problems, most notably the SK Global accounting fraud in March 2003 and the financial problems at numerous credit card companies including LG Card. Subsequently the effectiveness of the supervisory system in improving the soundness and competitiveness of the financial institutions and the financial system in the Korea has been questioned. Government officials and financial experts are now discussing a new organizational structure for the supervisory agency (the FSS; the FSC is the steering commission of the FSS), and the optimal institutional relationship between the MOFE and the supervisory agency. It should be noted that in the SK Global case the *criminal enforcement* of corporate governance standards has proved successful.

188. Bank Negara **Malaysia** (BNM, the central bank) is the statutory body responsible for; *inter alia*, the regulation of financial institutions (banking institutions, merchant banks, finance companies, discount houses and money broking companies). In the context of listed financial institutions, BNM plays a role in the prudential regulation of the activities of such entities in addition to the regulation of public listed companies by the Securities Commission and Bursa Malaysia (the exchange). BNM has issued a number of corporate governance related regulations since the White Paper; the following is a summary:

- 29 May 2003, *Guidelines on the Establishment of Board Committees, Minimum Qualifications and Training Requirements for Directors and Definition and Responsibilities of Independent Directors*: guidelines on the establishment of the nominating committee, remuneration committee and risk management committee; minimum requirements on the terms of reference of the board committees; expected roles and responsiblities of the committees; minimum qualifications and training requirements for directors; and definition and the roles and responsibilities expected of independent directors

- 29 March 2005, *Appointment and Role of Chairman, and Resignation and Removal of Independent Directors*: these guidelines apply to the licensed institutions and bank/financial holding companies and state that (i) appointment of chairman requires the approval of BNM, (ii) chairman should be a non-executive, (iii) roles of chairman and CEO should be split; in addition, regarding Resignation and Removal of Independent Directors: (i) all resignations and removal of independent directors can only take effect after they have cleared the resignations and removal with BNM

- 5 October 2004, *Revised Guidelines on Financial Reporting for Licensed Institutions (BNM/GP8)*: the objective hereof is to ensure consistent disclosure of all material and exceptional facts among the financial institutions to facilitate evaluation, assessment and comparison of the financial position & performance of the financial institutions (including corporate governance disclosure)

- 8 August 2003, *Guidelines on the Appointment of External Auditor*: in summary (i) mandatory rotation of engagement partner (auditor) after a period of 5 years from the appointment date; (ii) engagement partner is responsible for signing the auditor's report in the annual accounts of the financial institutions; and (iii) provision of non-audit service by the external auditor requires the pre-approval of Audit Committee

- planned for September 2005, *Revised Corporate Governance Framework for Licensed Institutions*: the framework will be replacing the current Guidelines on Directorship in Banking Institutions (BNM/GP1)

189. The following is a summary of key corporate governance related achievements and initiatives taken by the **Pakistan** government and the State Bank of Pakistan (SBP), which is both the Central Bank and the regulatory authority for banks and Development Finance Institutions (DFIs) in Pakistan, over the past few years (as per 30 August 3005) and included in separate regulations: governance related regulation by BSP includes:

- Issued on 28 October 2003 and effective from 1 January 2004, *Prudential Regulations (PRs) on Corporate Governance*, deal with corporate governance of banks (Regulation G-1: Corporate governance / board of directors & management; Regulation G-2: dealing with directors, major shareholders and employees of the banks/DFIs; Regulation G-3: Contributions and donations for charitable, social, educational and public welfare purposes; and Regulation G-4: Credit rating)
- The PRs contain fit and proper test for CEO's, board members and key executives have. Those who do not fulfill the criteria laid down in the test are not allowed to hold the respective office
- Minimum disclosure requirements (quarterly and yearly) have been prescribed for banks
- Family representation on the boards of banks has been limited to 25 percent and the remaining directors have to be independent non-executive non-family members
- Conflict of interests rules have been adopted, barring stock brokers, money changers and all those having any potential conflict from becoming involved in the management and oversight of banks
- External audit firms are screened, categorized and rated for the purpose of auditing the financial institutions. Wherever they are found deficient, they are de-listed or even black-listed
- In 2003 the *Handbook on Corporate Governance for Banks* has been published in order to disseminate international best practices and SBP's instructions. The objective of this handbook was to provide guidelines for Board of Directors, managers and shareholders. Most of the recommendations and guidelines stated in the handbook are

directly drawn from the recommendations made by the Basel Committee on corporate governance and the OECD. These guidelines cover four important areas, namely, Board of Directors, Management, Financial Disclosure, and Auditors.

SBP claims that these steps have resulted in better market discipline and conduct, improved risk management, better board members and a better banking system. SBP is one of the founding members of the recent launched Pakistan Institute of Corporate Governance which underlines its commitment to promote corporate governance. Finally, the SBP in 2004 also issued *Guidelines on Internal Controls*. These guidelines are to ensure efficiency and effectiveness of operations, reliability, completeness and timeliness of financial and management information and compliance with policies, procedures, regulations and laws.

190. In the **Philippines**, the Bangko Sentral ng Pilipinas (BSP, the central bank) has been a major player in pushing forward corporate governance reforms in the banking system. It has issued a number of Circulars on corporate governance for the banking sector (BSP Circulars 283 & 296). Moreover BSP has included corporate governance in its examination and supervision of banks. Recent corporate governance related regulation by BSP includes:

- 15 July 2003, Circular No. 391, Policy guidelines for the board of directors of banks, quasi-banks and trust entities: (i) Limits on the number of members of the board of directors with requirement of two independent directors; (ii) Qualifications of independent directors; (iii) Procedures for disqualifying directors/officers; (iv) Confirming authority for elected/appointed directors/officers

- 20 August 2003, Circular No. 391, Policy guidelines for the board of trustees and officers of non-stock savings and loan associations (NSSLAs): (i) Definitions, qualification, powers and general responsibilities of the board of trustees of NSSLAs; (ii) Specific duties and responsibilities of the board of trustees and of a trustee; (iii) Qualification of officers; (iv) Disqualification of trustees and officers; (v) Persons disqualified from becoming officers; (vi) Disqualification procedures; (vii) Effect of non-possession of qualification or possession of disqualification; and (viii) Watchlisting

- 16 September 2003, Circular No. 406, Regulation allowing an independent director of a bank/quasi-bank to be an independent director of parent, subsidiary, affiliate or other related companies

- 29 October 2003, Circular No. 410, Rules and regulations on the selection and delisting by the Bangko Sentral ng Pilipinas of external auditors of banks, quasi-banks, trust entities, non-stock savings and loan associations, their subsidiaries and affiliates engaged in allied activities and other financial institutions which under special laws are subject to BSP supervision: (i) Selection requirements for external auditors; (ii) Application for BSP selection; (iii) Required reports; and (iv) Grounds and procedure for delisting
- 8 March 2004, Circular No. 421, Guidelines for disqualification of directors/officers: (i) Procedures for disqualification; and (ii) Watchlisting of directors/officers
- 11 May 2004, Circular No. 429, Policy guidelines on compliance function: (i) Responsibilities of the board of directors and senior management on compliance; (ii) Role and responsibilities of the compliance function, (iii) Independence; and (iv) Cross-border issues
- 18 May 2004, Circular No. 434, Amendment of rules on the duties and responsibilities of the board of directors: (i) Creation and responsibility of audit committee; and (ii) Enforcement powers of the Monetary Board for unsafe and unsound conduct of business
- 16 July 2004, Circular No. 441, Attendance of directors in board meetings
- 29 September 2004, Circular No. 455, Selection and inclusion of external auditors of banks in the BSP list
- 4 October 2004 (in force as of 1 January 2005), Circular No. 456, Amendment of regulations relative to the specific duties and responsibilities of board of directors, Constitution of different committees (e.g. audit committee, corporate governance committee, risk management committee)
- 3 February 2005, Circular No. 474, Amendment of regulations on the requirement for the conduct of annual financial audit
- 22 February 2005, Circular No. 477, Rules of procedure on administrative cases involving directors and officers of banks, quasi-banks and trust entities

Furthermore BSP Circular no 243 (2004) provides rules for an expanded monitoring of certain loans for groups of companies with cross holdings and directorships. The BSP together with the SEC, the Insurance Commission and the Energy Commission have all required their directors and senior executives (in the case of insurance companies) to undergo a training session on corporate governance.

191. In **Singapore** the Monetary Authority of Singapore (MAS) in February 2003 issued a consultation paper on proposed guidelines and regulations to enhance the existing corporate governance framework for locally incorporated banks and direct insurers. This is an ongoing effort. In addition the Strategic Planning Office of the MAS is leading the MAS Act Review in order to enhance corporate governance of the MAS and allow the organisation to carry out its functions more effectively. On 8 September 2005 the MAS issued Corporate Governance Regulations ("Regulations") and Guidelines on Corporate Governance ("Guidelines"). The Regulations and Guidelines are enhancements to existing corporate governance requirements for banks, financial holding companies and direct insurers. The Regulations (consisting of two separate sets for the banking and insurance sector, i.e. the Insurance (Corporate Governance) Regulations 2005, and the Banking (Corporate Governance) Regulations 2005), which are mandatory, form the minimum corporate governance standards for banks, financial holding companies and significant insurers incorporated in Singapore. Requirements that MAS considers essential for sound corporate governance are included in the Regulations. These include requirements on (i) the composition of the board of directors (Board); (ii) establishment, composition and responsibilities of various board committees; and (iii) separation of roles for the Chairman of the Board and Chief Executive Officer. The Guidelines, which are based on the Code of Corporate Governance (Code) issued by the Council of Corporate Disclosure and Governance (CCDG), are best practice guidelines that banks, financial holding companies and direct insurers incorporated in Singapore are strongly encouraged to adopt. The Regulations and Guidelines took into account feedback received from a public consultation as well as extensive consultations with the industry. Banks and significant direct life insurers will be given until their respective annual general meetings (AGMs) in 2007 to comply with the Regulations. Banks and direct insurers listed on the Singapore Exchange should disclose their corporate governance practices and explain deviations from the Guidelines in their annual reports for AGMs held from 1 January 2007 onwards.

192. In **Chinese Taipei** the FSC commissioned the Bankers Association and financial holding companies to draft (i) the Corporate Governance Best-Practice Principles for Banks and (ii) the Corporate Governance Best-Practice Principles for Financial Holding Companies. These Best-Practice Principles aim to enhance legal compliance and internal management, protect stockholders' interests, strengthen the function of the board, and

improve information disclosure. They have both been put into practice since 31 December 2003 and have been lastly amended on 5 January 2004 respectively 13 July 2005. The FSC has also required banks and financial holding companies to disclose the state of corporate governance in their annual reports to strengthen the implementation of corporate governance.

193. In **Thailand** the National Corporate Governance Committee (NCGC) was set up in 2002 with the mission of setting out policies, measures, and schemes to upgrade the level of corporate governance in Thai business. A sub committee was set up to ensure that policy or measures originated by NCGC can be practically applied. The sub committee divided its work into 6 areas and one area is promoting governance in the bank sector. In 2002, the Bank of Thailand (BOT) issued the Financial Institutions Directors' Handbook and a policy statement on board structure to enhance corporate governance practices of a commercial bank. It prescribes due roles and responsibilities of the bank' directors, board of directors as well as composition of various sub committees of the bank. Also, in November 2002 criteria for the appointment of external auditors were issued, aiming to emphasize the importance of control and transparency, including frameworks and regulations on risk management. Since then, BOT continues to place emphasis on its implementation by examining and assessing the bank's practices and adherence to the policy, at the same time ensuring that the banks themselves realize the importance and benefit from adhering to such policy. In addition, on 27 July 2004 BOT has stipulated fit and proper criteria for senior management and directors of commercial banks. The notification issued under virtue of the Commercial Banking Act prohibits banks from appointing any persons with undesirable attributes to the positions of senior management and executive directors.

194. The **Vietnamese** policymakers have imposed some limited regulations in order to reform the banking system, including a regulation which focuses on a pilot equitization project of state owned commercial banks. In a presentation at the International Corporate Governance Meeting in Vietnam (December 2004) a representative from the State Bank of Vietnam (SBV) formulated, amongst others, SBV's ambition of achieving a considerable change in infrastructure, capital resources, products offered, performance and security of banking sector by 2010. From 2010, Vietnam banking sector should be fully operated in accordance with international standards (Basel I, Basel II) regarding management, supervision and technology. The improvement of bank management capability and the financial health of banks should be achieved on the basis of speeding up reinvestment and ownership restructuring. The SBV

underlined that enhancing bank's performance and governance remains dependent on the outcome of SOEs reform in general.

6.3 Obstacles to progress, and Issues for further improvement

195. Considering the importance of corporate governance of banks, the Roundtable decided to establish a task force on corporate governance of banks in Asia. The Task Force has drafted a Policy Brief which provides policy recommendations for improving corporate governance of banks in Asia; it also refers to the challenges and obstacles to achieve such improvement. Therefore reference is herein made to the *Policy Brief on Corporate Governance of Banks in Asia*, a draft of which was discussed by the Task Force at the Roundtable meeting in Bali, Indonesia in September 2005. The final Policy Brief was launched in June 2006 at a meeting organized in co-operation with the Bank for International Settlements / Financial Stability Institute. Its executive summary is attached here as the Annex. Full text version is available at http://www.oecd.org/dataoecd/48/55/37180641.pdf

ANNEX

Executive Summary of
The Policy Brief On Corporate Governance Of Banks In Asia (June 2006)

This Policy Brief identifies corporate governance issues that affect banks and the banking sector in Asia. Banks lend money that is in effect borrowed from depositors, and the failure of banks could result in a monetary loss for the depositors. The interests of depositors should be protected, and for this reason, amongst others, the Task Force believes that the importance of corporate governance of banks differs from that of other companies and needs special attention. The boards and management of banks have to take into account the interests of these non-shareholding stakeholders, i.e. depositors. Reflecting the relatively short history of economic development in the region, many Asian jurisdictions do not have in place sufficient institutional infrastructure (e.g. sufficient resources, experience, focus, and know-how) necessary for effective enforcement of the corporate governance policy framework. Asian banks play a dominant role in regional finance due to the yet immature capital markets, and Asian policy makers should be aware that sound corporate governance of banks cannot be developed effectively without tackling institutional constraints and weaknesses.

The boards of banks should act in line with their fiduciary duties. The fiduciary duties of all board members (i.e. not only of independent directors but all members of the board) include both the duty of care and the duty of loyalty. The fiduciary duties of bank's board members are arguably more important than those of other companies because of the bank's acceptance of public money in the form of deposits. Board members should maintain an attitude of "healthy scepticism" in their assessment of the bank's strategies, policies and processes. Their skills should be enhanced by ongoing training programs that underscore their heightened fiduciary duties. Maintaining and promoting both personal integrity and professionalism of board members of banks is indispensable for the boards to function effectively and properly.

Boards should set the right tone at the top. The board's focus areas should include guiding, approving and overseeing the bank's strategic objectives, corporate values and policies. An important aspect thereof should be the development of a code of conduct for the bank employees, management, and the board members. The board should clearly define areas of responsibility, authority levels and reporting lines within the bank. Sufficient and material flows of information, internal and external, and managerial support to the board should be ensured.

Competence, integrity and qualifications are a pre-requisite for an effective board. Board members and executives should pass a “fit and proper person test” in terms of their competence, integrity and qualifications both on the occasion of their appointment and on a continuing basis thereafter. Banking supervisors may play a guiding role therein and in any event are expected to place more emphasis on securing sound corporate governance of banks they supervise rather than to focus only on regulatory compliance.

The board should be able to exercise objective and independent judgement. This is necessary for monitoring managerial performance, preventing conflicts of interest and balancing competing demands. This will mean independence and objectivity with respect to management and controlling shareholders, with important implications for the composition and structure of the board. Although this requirement applies to all companies, in Asia especially banks should be more encouraged than other companies to have independent directors on their boards. One of the main reasons for this is that abusive related party transactions (including lending) may have more serious consequences in banking than in most other industries. “Independent” directors should be independent not only of management but also of controlling shareholders.

Although mandatory separation of the positions of chairman of the board and CEO is not widespread in Asia, the Task Force considers that the separation of these two posts, with due consideration to the business environment in a jurisdiction, can contribute to a more appropriate balance of power, increased accountability and improvement in the board’s capability for decision-making, independent of management.

Bank boards have found it beneficial to establish certain specialised committees. The audit committee or an equivalent body should, amongst its other duties, ensure that the bank adheres to accounting and auditing standards and practices within the jurisdictions in which the bank operates. Moreover, the bank’s internal auditors should report directly to the audit committee or an equivalent body on matters concerning the effective implementation of policies and controls that are within the competence of the committee. The audit committee is ideally made up of independent directors with appropriate banking and financial expertise. The establishment of a risk management committee should also be encouraged, with the primary duty of overseeing that the bank’s risk management system is properly implementing the risk policy of the bank. The committee structure within the board should preclude decision-making becoming the prerogative solely of any single individual or of a controlling owner, without a system of independent checks and balances.

Boards should manage related party transactions using independent directors. Even if related party transactions themselves may be harmless, it is not always easy to judge whether they are on market terms and the mere appearance of conflicts of interest may undermine the ethical code of the bank. Asian experience has shown that special focus should be given to the credit allocation process that banks observe. The specific corporate governance challenge in this regard continues to be that of ensuring that this process is conducted with a view to securing the long-term viability and sustainability of the bank, thereby maximising its long-term value.

Existing regulations covering a bank's lending exposure to a single client, including exposure to related entities owned or controlled by a single client, should be properly implemented and enforced, and where necessary, tightened. A mandatory maximum percentage of lending exposure to a single client of a bank's capital should be set by banking supervisors.

Jurisdictions in Asia should examine whether their current regulatory firewall framework needs to be reinforced in order to ensure that (i) transactions with controlling shareholders, directors and senior management be conducted on an arm's-length basis, and (ii) proper professional distance is maintained between the credit decisions of banks and the borrowers to which they are related. Related party transactions should be reviewed and monitored by a sufficient number of independent directors capable of exercising independent judgment. In addition, the Task Force stresses the White Paper's recommendation for utilising board committees as a common mechanism for controlling matters involving potential conflicts of interest (White Paper #322).

Related party transactions should be a priority for supervisors. Banking supervisors should implement a strict regulation in which minimum criteria for transactions with related parties that pose special risks are clearly defined. In accordance with international standards for accounting, auditing and non-financial disclosure, banks (including non listed banks if legally possible under the national registration) should publicly disclose material related party transactions.

Moreover, the option of outright prohibition from engaging in *certain specific types of* related party transactions, such as personal loans to board members and controlling shareholders (White Paper #117) should be considered by banks and supervisory authorities.

Banks within groups of companies are commonplace in Asia and need special attention. The corporate governance structure and practices of a bank within a group of companies should be in accordance with the generally accepted good corporate governance practices. For instance, the board members of the bank, even if they are appointed by the parent company, should be aware that they have specific duties to depositors in addition to the fiduciary duties to all shareholders. Moreover, the bank should adopt firewalls to prevent abusive transactions within the conglomerate structure to which the bank belongs (“banking group”) to the detriment of the bank’s safety and soundness.

The parent company as a single or controlling owner of a bank should appoint a sufficient number of independent directors – independent of both management and the parent company - to the board of the bank and allow the board to fulfil its duties. Furthermore, the parent board itself should also have a sufficient number of independent directors and necessary board committees.

The banking supervisors should also assess the fitness and propriety of the board members and executives of the parent company. Banking supervisors should have the legal authority and tools to effectively supervise the banking group including the parent company.

The legal framework in a jurisdiction should not allow the group structure to obscure where responsibilities lie between a bank and its parent company. Legal obligations of the board of the bank and its parent company should correspond to where decisions are made in the banking group.

Public disclosure is crucial for ensuring sound corporate governance of banks and promoting financial stability. Listed banks should be required by national laws and regulations to be in compliance with international accounting standards and practices as well as the guidance set forth by the Basel Committee in its various publications. Non-listed banks, in so far as they are required to disclose their information to the public, should also adhere to these standards and practices. The Task Force stresses the importance of co-operation between banking supervisors, securities regulators and stock exchanges in terms of public disclosure by listed banks.

State-owned commercial banks should be a role model for good corporate governance. From a corporate governance policy perspective the different roles of the state as (i) a regulator and supervisor, and (ii) an owner of state-owned commercial banks (SOCBs), need to be considered separately. The state should be aware of the potential risks that its intervention, either through prudential regulation or state-ownership, may result in undesirable and potentially harmful consequences. Once the state as sole shareholder has set the objectives for the SOCBs, it should let SOCBs' boards exercise their responsibilities and respect their independence. The 2005 OECD Guidelines on Corporate Governance of State-Owned Enterprises represent good practices which should also be applied to SOCBs.

Good corporate governance and privatisation are complementary. The Task Force welcomes the general trend towards privatisation of SOCBs in Asia, especially for those banks which were originally taken into state ownership as part of the resolution of a banking crisis. It is imperative for the success of privatisation of a

SOCB that the best corporate governance practices are already adopted and implemented prior to privatisation. By doing so, the privatised bank will function as a role model and thus may create market pressure on other banks to adopt better corporate governance.

Asian banks should play an important role in improving the corporate governance structure of their corporate borrowers. The Task Force suggests banking supervisors to develop incentives for banks in Asia to recognise and consider that it is in the best interests of the banks themselves to assess and monitor, *ex-ante* and *ex-post*, the corporate governance structure of its corporate borrowers as a critical part of their ongoing credit risk management.

Banks often allow their employees to act as a member of the board or senior manager of debtor companies even if they do not hold any shares. While bankers with deep knowledge of corporate finance may be able to contribute to these companies, such activities should nevertheless in general be discouraged because of the potential conflicts of interest.

Ensuring sound corporate governance of banks themselves is an essential prerequisite if the banks are to play a more active role in improving the corporate governance of their corporate borrowers.

Asian banking supervisors should take the lead to improve corporate governance of banks in Asia. The Task Force recommends that in all Asian jurisdictions banking supervisors (or banking industry associations, while exchanging views with banking supervisors), in conjunction with securities regulators and stock exchanges (or institute of directors, when appropriate), develop national codes of corporate governance of banks, a template on which banks should base the development of their own codes respectively, based in turn on the conditions of each jurisdiction and on existing corporate governance codes.

Furthermore, banking supervisors should provide incentives for banks to improve their corporate governance. For instance, they should develop rating mechanisms for corporate governance of banks. The methodology of the ratings of corporate governance of banks should be clearly articulated, well in advance in order to provide time for banks to reorganise their framework.

(Full text version of the Policy Brief is available at

http://www.oecd.org/dataoecd/48/55/37180641.pdf)

Implementing the White Paper on Corporate Governance in Asia

STOCK-TAKE PROGRESS ON PRIORITIES AND RECOMMENDATIONS FOR REFORM

This stock-take report has been called for by the Asian Roundtable on Corporate Governance in its *2003 White Paper on Corporate Governance in Asia*, in order to assess the progress of implementation of the six priorities and 36 recommendations for corporate governance reform formulated in the White Paper. The stock-take exercise has given Asian policy makers, practitioners, academics and other stakeholders the opportunity to express their views on corporate governance policy reform in the period from 1 January 2003 up to 1 January 2006. This report will enable the Asian Roundtable on Corporate Governance participants and the public to assess progress and to identify remaining challenges and obstacles.

The Asian Roundtable on Corporate Governance is a policy forum that comprises Asian policy makers, regulators, stock exchanges, academics and private sector leaders, as well as international experts.

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