



Influencing Corporate Governance

The role of pension funds in Asia

By Dr. Mak Yuen Teen

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pension funds in influencing Corporate Governance and executive pay in the corporations they invest in.

Q: What role/influence do Asian pension funds have in determining Corporate Governance in the corporations they invest in?

A: Asian institutional investors, including pension funds, are currently

generally passive, as are Asian fund managers. The institutional investors which are more active in Asia in corporate governance are actually global investors. The environmental, social

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and governance (ESG) perspective to investing is being increasingly embraced by global institutional investors.

Q: Do you see this 'generally passive' attitude changing as Asian companies (those in which pension funds and fund managers invest in) face increased pressure from the on-going financial tsunami?

A: I think the financial crisis will put more pressure on institutional investors and fund managers to be more active on corporate governance issues. Prior to the crisis, the lack of institutional shareholder activism has already been highlighted regularly by regulators, policy makers and commentators. Further, the growth of exchange-traded funds raises questions about the business proposition of beta fund managers. Research cited in the business media has also questioned the ability of fund managers to consistently deliver alpha, which obviously leads to questions about even the value proposition of alpha managers. Becoming more active in corporate governance may be a more important differentiator for fund managers going forward.

But some institutional investors and fund managers in Asia remain unconvinced that they should be investing resources into engaging with companies they invest in to improve corporate governance. There are also questions about the extent to which some of these investors have adequately considered whether the corporate governance of the companies they are in is acceptable. Some major trading losses and failures have occurred in companies where the lack of corporate governance is quite evident with a little due diligence. A focus on corporate governance in investee companies is part of risk management of the investor.

One comment I have heard from an institutional investor is the 'free-riding' problem – that an investor which invests in shareholder activism may

incur the costs while everyone else reaps the gain. However, the growth of governance-focused funds obviously indicate that many investors do not see it this way – that they see a focus on governance as allowing them to reap long-term returns in excess of the cost of shareholder engagement.

From what I can see, the growth in institutional activism in countries like the US and UK sprung from threats of regulation – in other words, that if institutional investors and fund managers don't self-regulate and be more active in shareholder engagement and discharge their duty to beneficiaries, the government may force them to do it. So, collective action happened and institutional shareholder associations and networks were formed. In the UK, the Combined Code on Corporate Governance specifically includes a section on the role of institutional investors – something codes of corporate governance in Asia generally do not have.

Asian institutional activism will depend on how much pressure governments, beneficiaries and the media will put on the institutional investors. It is not a certainty that they would become more active even with the crisis, and despite more losses and failures stemming from corporate governance weaknesses. Institutional shareholder activism hasn't happened in most Asian countries even though it has been frequently highlighted for many years as a cause for the slow pace of corporate governance improvements in Asian economies. In many of these countries, it is actually associations catering mainly to retail investors which are more active.

However, for institutional investors and fund managers to be able to be more active, there also need to be a look at how to remove or reduce the barriers to shareholder activism. The Asian Corporate Governance Association (ACGA) based in Hong Kong did a study on proxy voting which

highlighted major barriers across Asia. ACGA has been active in various countries in engaging with regulators to try to get changes to legislation and soft laws to make it easier for institutional investors and fund managers to be more active.

For example, the UK Railway Pension Trustee Company (Railpen), which is invested in about 40 Singapore listed companies have started shareholder engagement activities in Asian countries, and have developed corporate governance policies for their investee companies. Amongst fund managers, Aberdeen is probably seen as one of the most active in corporate governance in Asia.

Q: From your perspective, what corporate governance policies for the investee companies should pension fund investors focus on?

A: In my view, the quality of corporate governance in companies is dependent on the integrity of 3 key players – the controlling shareholder, the board (especially the Chairman) and the CEO. Most corporate governance scandals are connected to the conduct of the controlling shareholder or CEO, who is often the board chairman or closely connected to him or her. These individuals essentially define the DNA of the company. The right tone at the top is the most important because if that is not there, structures, systems and processes to enhance governance will not work. Having an independent and effective board and a competent CEO are obviously also important. Independence of the board is critical but the board also needs to have a good mix of competencies, individuals who are able and willing to ask questions and offer a diversity of viewpoints (which you are more likely to get if you have people from different backgrounds, gender mix, local and foreign directors, etc.) and professionalism (integrity, commitment, etc.). Ultimately, corporate governance is about enhancing long-term shareholder value, so the board



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also needs to have the capability to guide the company on strategies and help the business to be profitable.

Other elements which are especially important are an independent and competent audit committee, strong internal controls and risk management, good remuneration policies and disclosure, and accountability to shareholders. In Asia, related party transactions that are not prejudicial to minority investors are an especially important risk.

Q: Is 'executive pay' a focus right now?

A: From my perspective, executive pay in Asia has not received the same attention because it has generally not reached the levels in the US especially. However, Railpen's Singapore Corporate Governance Policy for example, does focus on etc.

Q: Do you think executive pay may become a focus any time soon, especially in the wake of the global financial tsunami?

A: Misaligned incentives which encourage growing short-term profits and share prices, at the cost of excessive risk-taking, have been singled out as one of the major causes. I would expect more attention especially on the design of incentive pay schemes in Asia. Executive pay disclosures are generally poor in Asia by international standards, and more attention could be focused on that, rather than the levels of pay per se as is the case in the U.S.. The poor disclosures mean that it is often difficult to know how much directors and senior executives are paid, so it becomes a difficult issue to question.

Q: Why is there less pressure for Asia institutional investors?

A: Regulators and policymakers have relied more on encouragement than threats of regulation to improve institutional activism. One can only guess why this is so.

Q: Do you see this situation (less pressure) changing any time soon?

A: I could see Asia institutional investors and fund managers becoming more active because of enlightened self-interest. At this point, it is difficult to assess if there would be more pressure coming from regulators.

Q: What would it take to change this situation? (e.g. legislative reform, investor education, market conditions, etc.)

A: I think the most important would be if regulators become more explicit in making those who look after other people's money do more. For example, having a code for institutional investors and fund managers setting out their responsibilities will help. Removing barriers will also help. Investor education, including educating investors to expect more of those who look after their money, will help too.

There are more hurdles to shareholder activism in Asia. In addition to the concentrated share ownership and control already mentioned – which makes it harder for institutional investors holding relatively small stakes compared to the controlling shareholders to effect positive changes, there are other barriers. One example is the rules limiting participation of institutional investors in general meetings (because the laws generally recognize only nominees who are direct legal owners of the shares, not the fund managers or the institutional investors).

Q: How can these hurdles be overcome?

A: I think through a combination of legislation reforms, listing rule changes, and through codes of corporate governance.

From my own experience, global institutional investors are more active than domestic institutional investors in trying to get countries to improve their proxy voting systems to increase their ability to participate in

meetings, vote their shares, etc.

I would expect global institutional investors to continue to increase their focus on corporate governance, especially in light of the crisis and corporate governance issues which have contributed to it. I also expect more domestic institutional investors and fund managers to do so, although this will depend on the extent to which regulators put more pressure on them. If governments reform company law and improve the access of institutional investors and fund managers to proxy voting, then we may also see more being done by both foreign and local institutional investors.

Q: How do you assess the attitude of Asian regulators towards enhancing corporate governance? For example, are they amenable to reforming company law to improve access to proxy voting? If not, why not?

A: I would say they do see good corporate governance as important but are rather cautious at the same time. There is a constant consciousness about the need to balance the interests of those who control and run companies, and minority investors in those companies, because of wanting to attract listings and concerns about raising business costs. **W**

With contributions from Bayani Cruz, Editor, Asia Asset Management. Extract from this interview are also published by Asia Asset Management, February 2009 edition



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