**Corporate Governance: Turning the Tables on Institutional Investors**

**July 2019| Kevin Smith, Delft Partners**

In the light of a plethora of commentary on ESG issues we wanted to re-post our observations on ESG in Asia. This is by Kevin Smith Head of Asia Pacific Equities at Delft Partners.

I attended the Asian Corporate Governance Association (ACGA) Annual Conference in a very polluted Beijing last month along with a record number of delegates, 350 in total representing three broad groups; institutional investors, corporates and asset owners. We normally attend conferences with our peer group of institutional investors while corporates make presentations, this environment was different and refreshing, with the corporates able to provide feedback to investors and asset owners regarding their ever-increasing demands for information.

ACGA Secretary General Jamie Allen set the scene for the conference with his presentation "Mapping the CG Ecosystem", the ACGA survey of corporate governance in the region has been broadened in 2018 and for the first time includes an assessment of investors. Scores across the region in the eight categories of assessment were as follows:

| Category 利益相关者类别 | Average % 平均分 % | Lowest % 最低分 % | Highest % 最高分 % |
|---|---|---|---|
| 1. Auditors & Audit Regulators: 审计及审计监管 | 68 | 39 | 84 |
| 2. CG Rules: 公司治理规则 | 60 | 33 | 79 |
| 3. Regulators – Enforcement: 监管机构——执法力度 | 54 | 19 | 78 |
| 4. Listed Companies: 上市公司 | 53 | 36 | 73 |
| 5. Civil Society & Media: 社会公众及媒体 | 51 | 22 | 78 |
| 6. Regulators – Funding, Capacity, Reform: 监管机构——预算、人力和监管改革 | 50 | 22 | 62 |
| 7. Government & Public Governance:政府及公共治理 | 46 | 23 | 65 |
| 8. Investors: 投资者 | 34 | 18 | 63 |

- New 6-point scoring system—forcing some scores down.
  新的六分制——迫使一些分数下降。

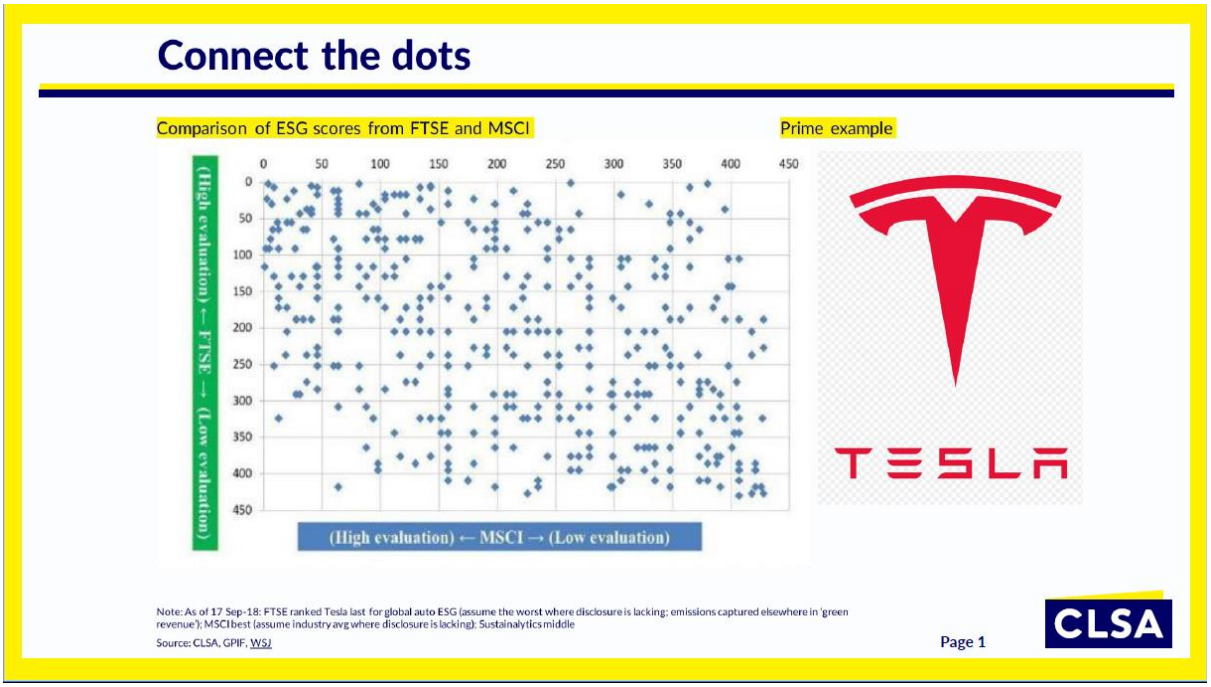
I am sure it will be a big surprise to many institutional investors to see themselves with such low scores in relation to governance. Institutional investors scored poorly for their voting activity and especially the disclosure of their voting at AGMs.

There was a recurring theme throughout the conference, corporates have had enough of seemingly endless demands for governance information from institutional investors, each in different formats and typically required within impossibly tight time deadlines. At the other end of the scale, there are large numbers of institutional investors acting a free-riders, enjoying the benefits if improved governance without any active participation.

One of my key conclusions from the conference was that the structure for assessing and regulating corporate governance in the Asian region is largely complete. There are rules in place of a very high standard with Japan, Hong Kong and Singapore leading the way, we need to see those rules replicated across other countries in the region and then high standards of enforcement applied.

There has been one significant backward step in the past year, competition among exchanges for large new listings has resulted in Hong Kong and Singapore adjusting listing rules allowing companies to list with dual-class shares. The CFA Institute published a good paper on this subject titled "Dual-Class Shares: The Good, The Bad, and The Ugly" which is worth reading. We are strongly opposed to dual-class shares which act to undermine fairness between shareholders. We agree with the CFA Institute conclusion that "one-share, one-vote remains the fairest and most optimal market practice". We also share the CFA Institute's concern that "allowing dual-class shares structures will lead to an erosion of corporate governance standards" and this trend of competition between regional exchanges could be seen as "a race to the bottom".

My favourite moment during the conference was a workshop session that posed the question "Is ESG data in Asia fit for purpose?" The term ESG is used in financial markets to describe the Environmental, Social and Governance behaviours of companies. The session was facilitated by Charles Yonts, Head of Power and ESG Research, CLSA, Hong Kong. Charles used the following slide to indicate the lack of agreement or correlation between the various ESG providers, in this case MSCI and FTSE, the random pattern on the chart shows that these two providers rarely agree on the ESG merits of individual companies with Tesla being a prime example; FTSE placed Tesla last and MSCI ranked the same company best in the global auto sector.




ESG scores are a potentially dangerous mix of fact and opinion neatly packaged into a simple number or rating. As the research house Bernstein pointed out in their article "Don't Let ESG Scores Hijack Your Portfolio" there are "important elements (that) can be lost in efforts to boil companies down to one number". We invest in companies in Asia that usually have three or fewer analysts providing coverage, those analysts tend to have just a few years of relevant experience. In many cases, there will be one or two inexperienced analysts providing the subjective opinion elements that go into the ESG score for a company. We are very happy to receive the facts regarding the governance of companies from external providers but prefer to rely on our own decades of investment experience when it comes to the subjective elements of an assessment.

Insights by Australian Fund Monitors Pty Ltd (AFM) provides investors and advisors with commentary and articles originated and provided by fund managers and other contributors. The views and opinions contained within each Insights article are those of the contributor and do not necessarily reflect those of AFM. www.fundmonitors.com.

Disclaimer: Australian Fund Monitors Pty Ltd, holds AFS Licence number 324476. The information contained herein is general in its nature only and does not and cannot take into account an investor's financial position or requirements. Investors should therefore seek appropriate advice prior to making any decisions to invest in any product contained herein. Australian Fund Monitors Pty Ltd is not, and will not be held responsible for investment decisions made by investors, and is not responsible for the performance of any investment made by any investor, notwithstanding that it may be providing information and or monitoring services to that investor. This information is collated from a variety of sources and we cannot be held responsible for any errors or omissions. Australian Fund Monitors Pty Ltd, A.C.N. 122 226 724