CORPORATE GOVERNANCE OF

50 TOP ASIAN BANKS[1]

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EXECUTIVE SUMMARY

Following the global financial crisis, bank regulators in many countries have introduced significant reforms with the aim of improving the corporate governance of banks. These reforms are significantly influenced by promulgations from global regulatory bodies such as the Basel Committee and the Financial Stability Board.

In this first ever study of the current corporate governance practices of large Asian banks, we examine a number of areas, including corporate and ownership structures, board structure and practices, executive and director remuneration, risk management, audits and implementation of whistleblowing policies.

The study covered 50 of the largest publicly-listed banks and bank holding companies by total assets which had up-to-date disclosures on key corporate governance practices. These 50 largest banks are from 10 Asian countries: China, Hong Kong, India, Indonesia, Japan, Korea, Malaysia, Singapore, Taiwan, and Thailand. Data were obtained primarily from the latest annual reports available in December 2012, supplemented by other sources such as company websites and regulatory filings which are publicly accessible.

FINDINGS

The key findings from our study are as follow:

- Of the 50 banks, 20 are subsidiaries of financial holding companies.

- Institutional investors are substantial shareholders in 35 banks, governments in 32 banks, and families in 4 banks. However, governments hold the largest stakes on average, with government substantial shareholders owning almost 40 percent in the 32 banks in which they are substantial shareholders, compared to mean ownership of about 24 percent for institutional substantial shareholders in the 35 banks in which they are substantial shareholders.

- Government and institutional substantial shareholders are the largest shareholders in all except 4 banks, with each being the largest shareholders in 23 banks.

- Bank boards are often large, with a mean and median board size of 13 board members. Almost a quarter have more than 16 or more board members and only 1 in 5 banks have 10 or fewer members.

- 40 percent of the bank boards have a majority of independent directors, but about 1 in 4 have less than one-third of independent directors. Three Japanese banks do not have independent directors and 10 percent of banks have more than two-thirds of independent directors.

- 12 percent of the bank boards have a majority of executive directors, and another 10 percent have between one-third and half of the board being executive directors. 18 percent have the CEO or equivalent as the only executive director on the board.

- Almost a quarter of the bank boards are all-male, and 40 percent have only one female director. In all the banks, female directors make up less than one-third of the board.

- Half the bank boards have independent directors with average tenure of 3 years or less. Only 7% of bank boards have independent directors with tenure averaging more than 7 years. 86 percent of bank boards do not have any independent directors who have served for more than 9 years.

- Half of the banks have executive directors with an average tenure of 3 years or less, and only about 1 in 4 banks have executive directors serving more than 7 years on average.

- Just under 40 percent of bank boards have an average age of directors exceeding 60 years, and just under a quarter have an average age of 55 years or less.

- Almost 80 percent of banks have executive directors who do not serve on boards of listed companies outside the group. 20 percent of banks have independent directors who serve on the boards of 3 or more listed companies on average outside of the group.

- 44 percent of banks have 5 or more non-executive directors with full-time employment in other organisations.

- More than one-quarter of the banks do not have any independent directors with prior full-time work experience in the banking industry. Just over 20 percent have at least 3 independent directors with prior full-time work experience in the banking industry.

- More than half of the banks have a Chairman who is an executive (i.e., Executive Chairman, or CEO and Chairman). Only 10 percent of the banks have an independent Chairman.

- More than 40 percent of Board Chairmen have held this role for two years or less, while 46 percent have held this role for 5 years or more.

- Only 5 percent of the banks have a lead or senior independent director.

- A quarter of banks boards met 16 times or more, while 9 percent met less than 6 times during the year. Just over a third met between 6 to 10 times.

- 42 banks (84%) have an audit committee, while 70 percent have a risk committee. Just under half the banks have a nominating committee and remuneration committee. Nine banks also have an executive committee.

- On average, the executive committee has 6 members, while the audit, risk and nominating committees have 5 members. Remuneration committees have 4 members on average.

- Just under half of the banks disclosed that they undertake annual board committee performance assessment, while just under 40 percent disclosed that they undertake an annual board performance assessment. Only 16 percent disclosed that they undertake annual performance assessment of individual directors.

- 28 banks disclosed the total remuneration of the CEO in exact amounts or in bands, as well as the dollar or percentage breakdown of different remuneration components. The median total CEO remuneration for these 28 banks is just over USD900,000, with the top three highest-paid CEOs from the three Singapore banks. On average, just over 50 percent of the CEO total remuneration is from annual (base) salary.

- Only 3 banks disclosed the key performance indicators for the CEO.

- Twenty-one banks have share option plans in place for senior executives, while 10 have restricted or other share award plans in place.

- Only 14 banks disclosed how they take into account risk in executive remuneration. Some examples of methods used include risk-adjusted return on capital ratio, adjusting the remuneration pool for risk, and adjusting performance-linked remuneration for factors such as credit costs and capital costs.

- Twenty-seven banks have a non-executive or independent Chairman, with 12 disclosing the remuneration of the Chairman. The median remuneration for these Chairmen is USD285,134, and the mean is about USD700,000. The highest-paid non-executive or independent Chairman earned USD3,813,537.

- The mean remuneration for non-executive directors (including non-executive or independent Chairman) is just under USD150,000 while the mean is just over USD100,000. The highest average NED remuneration is more than USD800,000.

- While most banks disclosed that they implement the Basel II framework, only about a quarter disclosed that they implement an enterprise risk management (ERM) framework.

- Nearly three-quarters of the banks disclosed that they have appointed a chief risk officer (CRO). Almost a third of these disclosed that their CRO also hold other line or staff positions.

- The Big 4 accounting firms account for more than 80 percent of the audits of all the banks. Chinese banks often have a domestic auditor and an international auditor, the latter being a Big 4 firm. Indian banks use domestic firms, not the Big 4 firms, as external auditors. Deloitte and KPMG lead in number of audits of the banks, with each accounting or just under a quarter of all audits.

- Seven banks did not disclose external audit fees. For those which disclosed, the median fee is USD4.1 million, while the mean is USD11 million. The highest audit fee paid is USD67 million.

- Only 9 banks disclosed a further breakdown of audit fees into categories. Only 9 disclosed how long the auditors have worked for the bank, including 7 of the Chinese banks.

- Thirty-two of the banks disclosed that they paid non-audit fees to the external auditors. For these banks, the median non-audit fee is USD517,393 while the mean is USD736,821. The highest non-audit fee paid is about USD3 million. Nineteen of these banks also disclosed further breakdown of types of non-audit services and amounts.

- Twenty-four banks disclosed that they have a whistleblowing policy in place. Of these, 10 disclosed that their whistleblowing policies allow for anonymous complaints, while 5 disclosed that their policy covers whistleblowing by external parties.

RECOMMENDATIONS

Our key recommendations for improving the corporate governance of Asian banks are:

Improve transparency in ownership structure:

The ownership and control of banks should be transparent. The use of pyramid and cross shareholdings should be clearly disclosed and ideally avoided.

Ensure good governance of subsidiaries and other group entities:

With trading and other scandals impacting a number of global banks, often occurring in group entities far removed from the parent company of the group, banks should ensure that they have an effective programme of governance for all group entities.

Ensure that the board is not too large:

With continuing focus of institutional investors on overly-large boards and research suggesting that large boards are generally less effective, boards should examine their size to ensure that they are not too large. They should consider reducing executive representation on the board if they have multiple executives serving on the board. This will also improve the independence of the board from management.

Improve board independence, competencies and diversity:

Boards should ensure that they have sufficient independent directors, who not only meet objective independence criteria imposed by regulators but are able to exercise independent judgement in the boardroom. They should also ensure that they have a good mix of competencies that take into account the nature of the business and strategies, and that there is adequate recent relevant experience of the industry. They should ensure that there is diversity of viewpoints, which can only be realised with directors who come from a diversity of backgrounds and social settings. Improving gender diversity can help to improve the diversity of viewpoints on boards.

Improve nomination processes for directors:

In order to balance board size and the need to meet requirements of independence, competencies and diversity, boards should improve their nomination process for directors and key officers. This should include a robust assessment of whether candidates meet "fit and proper" and other criteria and current experience and skills required and gaps. It should also consider the results of assessment of board, committee and director performance.

Improve board effectiveness:

Boards should strive to improve their effectiveness. In addition to improving selection processes, they should also improve their processes for assessing directors' independence and commitment; evaluating board, committee and director performance; and succession planning.

Ensure effective board leadership:

Banks should ensure that there is separation of the roles of the Chairman and Chief Executive Officer to avoid over-concentration of power in one individual and to provide better oversight of management. However, they should ensure that the Chairman has the right attributes, such as leadership skills and knowledge about the business, and is effective in leading the board.

Ensure clarity of roles and responsibilities of the board:

The diversity in composition (such as presence of executive directors) and meeting frequency of boards may be indicative of different roles and responsibilities of the board, in relation to oversight versus management. Boards should ensure that there is clarity in their roles and responsibilities.

Have appropriate and effective board committees:

Boards should establish appropriate committees to ensure that key decisions are adequately reviewed and discussed in sufficient depth by committee members with the appropriate expertise. In addition to an audit committee and a risk committee, they should consider establish a nominating committee and remuneration committee if they have not done so. They should consider having a combined nominating and remuneration committee to avoid fragmenting the board's work into too many committees, especially given the overlapping work of these two committees. Where boards have an executive committee, they should re-consider the need for such a committee.

Improve transparency of director, executive and staff remuneration:

With global concerns about level and structure of remuneration, especially for senior executives and staff holding "control job" functions, banks should review their remuneration policies and be more transparent especially with regard to remuneration components used and key performance indicators. They should also be more transparent about remuneration levels of directors and senior executives, and about how they take into account risk in their remuneration policies for senior executives and other key staff.

Ensure that directors are adequately remunerated for their expertise, responsibilities and time commitment:

With increasing responsibilities, greater time commitment and demand for specific kinds of expertise, banks should review their remuneration for non-executive directors to ensure that they reflect these developments. They should consider greater differentiation in fees amongst different directors based on their responsibilities, commitment, contributions and expertise.

Improve the training and development for directors and director candidates:

The increasing demands on directors and boards require a more structured approach to the training and development of directors and candidates for directorships. Such an approach can improve the ability of directors to address the issues we identified, such as remuneration, nomination processes, board and committee effectiveness and governance of group entities. Such training initiatives can also improve the pipeline and, therefore, ability of banks to address renewal and diversity issues.

Ensure clarity of role of the Chief Risk Officer (CRO) and avoid role conflicts:

Although many banks have appointed CROs, the role and reporting lines of the CRO need to be clarified. Role conflicts of CROs should be addressed to better ensure the independence and effectiveness of the CRO.

Improve transparency in external audits and non-audit services:

Banks should be more transparent in audit and non-audit fees paid to the main auditor and its network firms, and about the amount and nature of different services. They should pay particular attention to the external auditor and its network firms undertaking services that may pose a self-review threat to the external auditor's work and compromise the integrity of the external audit. They should also review the tenure of the external auditor to ensure that cost and other efficiencies from retaining the same auditor for an extended period are not outweighed by a decline in auditor independence and audit quality.

Adopt a comprehensive whistleblowing programme:

Banks should put in place a robust whistleblowing programme, which may involve having an external hotline. The whistleblowing policy should allow for anonymous complaints and allow for whistleblowing by external parties.