

Corporate Governance Development in the Thai Capital Market

Anyone who has lived through the Asian financial crisis of 1997 must have witnessed the rising trend of good corporate governance on a national and corporate level. This is understandable, and in fact indispensable, because weak corporate governance had accelerated the economic turmoil of the past decade. To prevent history from repeating itself, Securities and Exchange Commission, Thailand (SEC) set out on a mission to improve corporate governance practices in the capital market and regain confidence of local and international investors.

Now a decade has passed and, thanks to collective efforts of all parties concerned, Thailand has covered a lot of mileages in its drive towards international standard corporate governance. For starters, SEC corporate governance working group set up in 1998 proposed a strategic outline for corporate governance practices of listed firms covering five key areas in need of improvement. They are:

- (1) **Regulatory Reform** with special emphasis on protection of investors' rights;
- (2) **Checks and Balances** across the company board for the best interest of stakeholders;
- (3) **Information Disclosure** with more transparency, accuracy and sufficiency;
- (4) **Market Mechanism** such as shareholder activities, corporate governance rating and educational programs for both company directors and investors; and
- (5) **Effective Enforcement.**

On the national level, the government announced 2002 the Year of Good Corporate Governance and the Cabinet appointed the National Corporate Governance Committee (NCGC) chaired by Prime Minister and consisted of representatives from government and private sectors. The committee's role is to head the overall effort to strengthen investors' confidence in listed firms and market intermediaries, synchronise corporate governance development plans and monitor performance of relevant agencies.

In 2005, Thailand underwent corporate governance assessment by the World Bank under the Corporate Governance Report on the Observance of Standards and Codes (CG-ROSC). The CG-ROSC results indicate that Thailand's observance of international practices of corporate governance is approximately 69% largely observed and 31% partially observed. Since then the SEC has taken steps to address those areas of weakness identified by the assessment. This includes convergence of Thai accounting standards with the International Financial Reporting Standards (IFRS) and enactment of laws to provide more protection for minority shareholders.

Three Pillars of Success

Key success factors for corporate governance development in the capital market are:

1. Regulatory Discipline

Many steps have been taken to improve the regulatory framework of the Thai capital market which is based on the Securities and Exchange Act (SEA), the Public Limited Companies Act (PCA) and regulations under the SEC and the Stock Exchange of Thailand (SET). In 2008, the amendments to the SEA came into force, providing clearer scope of fiduciary duties, stipulating sanctions for breaches of those duties, and strengthening the rules governing related party transactions including stronger protection for investors' interests. The Ministry of Commerce's

proposed amendment to the PCA is being reviewed by the Council of State while the draft Bill amending the PCA would put in place additional mechanisms to protect investors' rights.

The SEC also proposed a class action bill which would enable shareholders and investors to pursue lawsuits against directors for breaches of duties more conveniently and cost-effectively. The draft bill is being reviewed by the Council of State.

In addition, to enhance corporate governance of listed companies, the SEC and the SET issued several regulations. For example,

- All listed companies are required to have independent directors composing of at least one-third of board size and audit committee composing of at least 3 members, which included all independent directors. Duties of the committee are to review the reliability of financial statement, comment whether the proposed connected transactions are fair and in the best interest of the company, review the sufficiency of internal control system, etc.
- Substantial related-party transactions must be approved by shareholders and disclosed in the annual report.
- All listed companies have to submit quarterly financial statements and the annual statement have to be audited by accredited auditors while the quarterly statements have to be reviewed. To put the IFRS convergence in place, the Federation of Accounting Professions (FAP) has revised the Thai accounting standards so that they comply with IFRS.
- To encourage companies to follow CG guidelines, listed companies are required to disclose in their annual reports whether they comply with the Principles of Good Corporate Governance for Listed Companies. Any non-compliance has to be thoroughly explained ("comply or explain").

2. Market Discipline

Investor activism is another main factor in encouraging listed companies to comply with good corporate governance practices. The measures that have been undertaken are as follows:

- As institutional investors (i.e. mutual funds, private funds, and provident funds) are considered a catalyst for fortifying good corporate governance practices among listed companies, the SEC issued rules requiring asset management companies to exercise their voting rights on all agendas that may affect shareholders or share value at the shareholder meetings of listed companies. Consequently, asset management companies must disclose guidelines of their proxy voting for investors' review. In addition, the voting record must also be disclosed in their websites annually;
- On the retail investor side, the Thai Investors Association (TIA) is the representative of investors, with one board lot shares in every listed company to gain access to shareholders meetings. If TIA sees inappropriate proposals, it may solicit proxy from investors to counter vote the major shareholders. In addition, since 2006, the SEC, in cooperation with the TIA and the Thai Listed Companies Association (TLCA), has conducted an assessment of the Annual General Meeting (AGM) to increase awareness of listed companies about the importance of AGM and to encourage shareholders' active participation. The SEC also provided an AGM checklist as a best practice guideline for listed companies. Over the last four years, most listed firms have made continuous progress as seen from the number of companies achieving good or higher score increasing from 52% in 2006 to 81% in 2009.
- Since 2001, the Thai Institution of Directors' Association (IOD) has conducted corporate governance surveys of Thai listed companies, which are based on the Principles of Corporate Governance of the OECD. The objective of this survey is to date of the governance practices employed by Thai firms. The overall survey results were published in a report entitled "Corporate Governance Report of Thai Listed Companies (CGR)" and publicised to all listed

companies and parties concerned in the capital market. The reports have helped Thai listed companies to significantly improve their corporate governance practices over the years, as can be seen from the overall average score, which increased from 50% in 2001 to 75% in 2008. In 2009, the IOD conducted a survey of 290 listed companies and the results showed an average score of 82%.

- Since 2008, the SEC has taken the further step of requesting every securities company to include each company corporate governance performance according to this CGR in their securities analysis reports. In 2009, all Thai securities companies have already disclosed result of the CGR in their research papers. This has made the report more valuable and widely used by the parties concerned. At the international level, several institutes of directors in the region also adopted the Thai IOD criteria in conducting surveys in their countries. In the future, the CGR will be developed to be a CG rating, which will enable investors to differentiate the good governance companies from the rest and can then attach higher value to those firms.

To increase awareness of good corporate governance via the media, the SEC and the SET regularly used several communication channels such as websites; publications; articles in newspaper; magazines; television programs; and exhibition to disseminate news and information about the Thai capital market including the elements and benefits of good corporate governance. In addition, in case there are specific issues the SEC and the SET will provide our message via remarkable channels such as the SET's column in the PostToday newspaper named "Enhancing Business with Corporate Governance", the SEC's column in Manager newspaper named "Think Out Loud with the SEC", the SEC's TV program on Money Channel named "Inside SEC". In the past several years, the financial newspapers have paid attention in corporate governance by regularly report on corporate governance issues such as transactions concerning acquisitions or disposal of major assets, the related-party transactions, results of shareholders' meetings, and corporate governance enforcement.

3. Self Discipline

Self discipline is another important driver of good corporate governance. The SEC, the SET and other institutions have provided guiding principles and codes of best practice for listed companies to enhance their corporate governance practices.

The Principles of Good Corporate Governance is an example of a guiding principle. In 2006, the SET launched the Principles of Good Corporate Governance, which was an updated version of the previous 15 Principles of Corporate Governance announced in May 2002. More principles have been added so that it is comparable to the Principles of Corporate Governance of the OECD. The 2006 version included recommendations made by the World Bank in its CG-ROSC. All listed companies must disclose their implementation regarding the principles in their annual registration statement and annual report.

The SEC, the SET and other professional institutions have provided many guidelines and codes of best practice for good corporate governance. For example: Director's Handbook; Financial Advisor Due Diligence; Nomination Committee Guidelines; Remuneration Committee Guidelines; Corporate Governance Self Assessment; Best Practice of Shareholders; Code of Best Practice for Directors of Listed Companies; Audit Committee Checklist, Director Compensation Best Practices, Director Nomination Best Practices; Internal Control Checklist; Q&A: Risk Management, etc..

In addition, educational programs and seminars for market participants are essential mechanisms to create awareness and understanding in the capital market. To date, series of training programs have been introduced by related organisations, such as:

- In 1999, Thai IOD was set up to provide several training programs for developing professional standard of directorship and provided best practice guidelines for company director to perform their duties effectively up to the international standards. Since the last decade, Thai IOD has offers various training programs for directors, audit committees, chairmen and other key persons in listed companies, for instance, Director Certification Program, Audit Committee Certification Program, Financial Statement for Directors, and Company Secretary Program. Currently, at least 3,500 directors of listed companies have attended one or more IOD classes.
- In 2002, the SET established the Corporate Governance Center (CG Center) to help listed companies achieve good corporate governance. CG Center provides free consulting services and exchanges ideas about corporate governance practices with directors and executives of listed companies.
- The SET also established the Thailand Securities Institute (TSI) to provide an educational program for investors. It offers many trainings and seminars to enhance the levels of financial and investment literacy of the investors and other market participants. Additionally, TSI has established “Train the Trainer” project, designated for professors in Economics, Finance, and Investment fields in academic institutions and experts in financial and capital market, who are key factors in distribution of knowledge to general public.
- Recognising that the legal issues in disputes under the SEA are complex and require specialised knowledge of capital markets and the objectives of the law, its training is mandatory for new judges. In this regard, the SEC provides annual training to existing judges and to the Office of the Attorney General (OAG).
- In recent years, several Thai universities introduced courses concerning corporate governance. Some universities even provide education programs dedicated to corporate governance courses such as Doctor of Philosophy Program in Good Governance Development, Chandrakasem Rajabhat University; and Master of Science Program in Corporate Governance, Chulalongkorn University.

Corporate Governance Development in Financial Institutions

- Commercial bank: realising the possibility of adverse effects that financial institutions may have on the economy and general public, the Bank of Thailand (BOT) has continued to enhance high standard of corporate governance to the financial institutions. The followings are examples of the BOT measure to promote good corporate governance:
 - The Financial Institutions Business Act of 2008, provides the BOT authority to define the appropriate structure of the board of directors and sub-committees of the financial institutions to establish checks and balances. Further, the appointment of directors and top executives and management of financial institutions must receive approval from the BOT. According to the BOT regulations, to gain approval the executives and management must hold fit and proper qualifications in three aspects including (1) honesty, integrity, and reputation (2) competence, capability, and experience (3) financial soundness.
 - Additionally, the board of directors of financial institutions must have main duties in four major areas including risk management, monitoring the capital adequacy, rules and regulations compliance and overseeing the good corporate governance.
- Insurance companies: the Office of Insurance Commission has (OIC), regulator of all insurance companies, has policy to promote corporate governance in the insurance sector.

Several notifications, guidelines, and best practices have been issued to support such policy. For example:

- Regulations on rules and procedures to formulate policy on internal control system and investments of the insurance companies;
- Regulations on criteria on approving external auditors of insurance companies;
- Regulations on scope of external audit on assessing internal control and investments of insurance companies;
- Insurance companies' director handbook; and
- Internal Audit Guidelines

Corporate Governance of State-Owned Enterprises (SOEs)

The State Enterprise Policy Office (SEPO) plays an important role in regulating and supporting state enterprises in order to ensure their good corporate governance and competitiveness, and in enabling them to become tools for Thailand's sustainable development. Currently, there are 58 state enterprises in nine sectors with the total assets of 6 trillion Bahts and the ability to generate total revenue of 2.7 trillion Bahts a year. However, with today's competitive market, SOEs can no longer use a traditional way of management. They must be able to effectively cope with the dynamic environments, such as economic globalisation and technological development. The SEPO has been endlessly initiating guidelines and strategies to create incentives for continuous improvement such as:

- Reformation and recovery plan for under-performed state enterprises
- State Enterprise Performance Appraisal system (SEPA)
- Remuneration system
- State Enterprise Awards (SOE Awards)
- State Enterprise Review (SER)

In addition, the SEPO has also developed "guidelines on good governance for state enterprises," which were granted the cabinet approval on 16 February 2001. These guidelines introduce mechanisms for creating transparency and effectiveness in the administrative system of state enterprises under six standards as follows:

1. Accountability: responsibility for outcomes of the organisational performance;
2. Responsibility: duties are performed with sufficient ability and efficiency;
3. Equitable treatment: all stakeholders must be treated equally;
4. Transparency: assessment of the overall operation and information disclosure;
5. Vision: creation of long-term value without compromising short-term capability; and
6. Ethics: good corporate governance and business ethics.

In 2009, the SEPO revised the guidelines to be comparable to OECD Guidelines on Corporate Governance of State-Owned Enterprises 2005. And the cabinet approved the updated guidelines on 3 June 2009.

In order to ensure that the appointed board member has appropriate skills and knowledge. The SEPO introduced Directors' Pool in 2008, to be a list of specialists with arrays of knowledge, skills, and expertise. The qualifications of experts in the directors' pool must comply with the principles and procedure of the directors' pool approved by the cabinet. In this regard, the General Qualifications of Member and Official of State Enterprise Act, B.E. 2518 (1975) and its Amendment (No. 6) B.E. 2550 (2007), stipulates that at least one-third of board members of the SOE who are not ex officio of any state enterprise shall be selected from the directors' pool of Ministry of Finance.

The Role of Professional Service Providers

- **Audit Firms**

The SEA requires listed companies to submit both quarterly financial statement and financial statement for any accounting period, which reviewed or audited (as the case may be) by an auditor. Moreover, the SEA also requires that such auditor must be in the approved list of the SEC. Auditors who perform their duties with professional standard will make the accuracy to financial information and enhance the investors' confidence to the financial reports.

- **Securities Analysts**

The SEC has policy to promote good corporate governance of listed by encouraging securities companies to consider corporate governance practices in listed companies which they invest. As mentioned earlier, in 2008 the SEC requested securities companies to include each company corporate governance scorecard according to the CGR in their securities analysis reports.

- **Credit Rating Agency**

Currently there are 2 approved credit rating agency in Thailand, TRIS Rating Co., Ltd. and Fitch Ratings (Thailand) Limited. In general, rating methodology covers 2 main components, which are (1) business risk analysis, encompassing an analysis of the industry and the business itself, and 2) financial risk analysis, primarily focusing on quantitative factors, such as major financial ratios, and qualitative aspects ranging from accounting practices to financial policy. For analysing business risk, the criteria includes corporate governance factors, such as management quality and transparency and organisation structure.

Enforcement of Corporate Governance Rules

The SEC, the SET, and other enforcement agencies have implemented several actions to enhance the enforcement. For example:

- **Unfair securities trading:** the SET monitored and investigated the securities trading practices. In case of discovering irregular practices that could have violated the securities law, the SET proposed such cases to the SEC for deliberation;
- **Related-party transactions:** the SEC closely monitors related-party transaction / material transactions deemed as acquisition or disposal of assets in order to deter inappropriate transactions that may cause improper benefit transfers. Should the SEC find ambiguous transactions, or an intention to report false information or concealment of information, it will take immediate action. For example:
 - requesting the company to submit clear and sufficient information;
 - encouraging more critical analysis on appropriateness and impacts of ambiguous transactions by issuing a public announcement;
 - urging investors to attend the shareholders meeting for protection their own interests;
 - in cases of suspected fraudulent transactions, the SEC will conduct in-depth investigations. If there is enough evidence, the SEC will file criminal complaints. As a result of the complaints, affected directors and executives shall not maintain his position in the company
 - since financial advisors have a major role in giving independent and professional opinions on transactions, the SEC regularly monitors the performance of their duties to ensure that they adhere to the governing rules, as well as the professional standards. The SEC also imposes punitive measures on financial advisors who fail to fulfill their duties in accordance with the rules;

- **Financial statement:** The SEC, in cooperation with the Federation of Accounting Professions (“FAP”), extensively monitored auditors’ performance. 100% of auditor reports on the submitted financial statements were reviewed. In case any suspicion arises, the SEC will also review their working papers to ensure that the financial statements are reliable and comply with the Thai accounting standards. For non-complying companies, the SEC will order them to make appropriate amendments as well as impose sanctions to the auditor and the companies (including directors and the executives in certain cases.)
- **Cooperation of enforcement agencies:**
 - the SEC and the Department of Special Investigation (DSI) of the Ministry of Justice strengthened cooperation to enhance the use of both organisations’ integrated expertise including the DSI’s greater power of investigation to secure facts and evidence for actions against the wrongdoers; and
 - the SEC became a full signatory to the IOSCO Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of information (IOSCO MMoU) to enhance effectiveness of cross-border enforcement.
- **Mechanisms for effective enforcement:** the Amended SEA provides more supportive mechanisms for effective enforcement of the securities law such as whistleblower protection and reward money for arresters or any persons who provide information on insider trading or market manipulation, etc.

The Next Steps

The Thai capital market corporate governance development has progressed significantly as can be seen from several reports such as those conducted by the Asian Corporate Governance Association. However, there are still areas for improvement. For example: the legislation on civil penalties and the class action law, which would help make enforcement of the Securities and Exchange Act more efficient, are in progress; the effectiveness of independent directors and internal control, which would be a substantial factor of check and balance system; and active roles of investors to promote good corporate governance among listed companies.

Conclusion

Corporate governance takes time to evolve and the target keeps moving with the increasing new demands from investors. However, with the strong support from the government and the high level of commitment from the relevant parties, the SEC believes that investors’ confidence in corporate governance of Thai listed companies will significantly increase.

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