

SEC's Expectation of the Role of Directors

Speech by Mr. Thirachai Phuvanatanarubala,
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Members of the board of the Thai Institute of Directors
Ladies and Gentlemen

1. I am pleased and honored for the invitation to address this Directors Luncheon Briefing, the first of this year. The president has informed us that there are more than 200 participants to this meeting. He very kindly suggested that it was because the members are interested to hear my speech. I rather suspect that it may have more to do with the free lunches being served. However, I follow the tradition that there is no such thing as a free lunch, I shall have to ask you to do some work. I shall ask you to deliberate in your mind - - along with me - - about the role of company directors.

2. The Thai Institute of Directors has done a lot in building awareness among company directors as to what their proper roles should be, in forging good governance. I congratulate you and sincerely hope that you will continue this important endeavor for a long time to come.

3. Governance is of course important. For the capital market, nothing is more important. You can have everything else, but without governance, all rules can be circumvented. All standards can be misinterpreted, and you will fail. In fact, if everyone has good governance, you can survive even without anything else.

Different levels of governance

4. Of course, you do not need the same level of governance in all forms of enterprise. For a man fishing and hunting for his own consumption, governance is not an issue. It does become an issue, however, when he starts involving other people. When that happens, even the smallest of enterprise requires governance. Because the firm has to pay taxes, therefore the tax authority will expect you to keep accurate accounts of your taxable income.

5. There was a saying in Thailand that if you want to see the true set of books, you have to ignore the income tax returns. The real set of books is the one that he discloses to his wife. But I was told that in reality, the genuinely true set of books is actually the one that is kept by the second wife. You can see that even at the level of family affairs, a certain level of governance is required.

6. The need increases when the firm starts to borrow from others, especially the banks. No enterprise can do big business if it is confined only to its own savings. You need OPM, or Other People's Money. The more OPM, the more opportunity for you to exercise your talents and skills to expand your businesses.

7. Talking about banking relationship, in Thailand it has been common, on the one side, for some bank customers to bump up the value of their collaterals to try to obtain bigger loans than they should. On the other side for the banks, a common pastime is for them to try to go after the customers that use the loans for purposes other than those declared to the banks.

8. If you go one more level up, when the firm starts to tap fund from the capital market, especially the type that may attract funds across national borders, the needs for governance multiply. Without proper governance, OPM, Other People's Money can easily deteriorate into OPR, Other People's Responsibility - - basically shifting the responsibility of governance to somebody else other than yourself.

Governance structure in Thailand

9. Governance is a stool with 3 legs; regulation, market forces and self-restraint. You need all three to ensure stability. We have achieved a lot of progress on the first leg of regulation. There is a national committee headed by the Prime Minister himself that sets the overall framework. To strengthen enforcement, the Prime Minister has also issued an Order setting up a committee to coordinate cases for prosecution comprising the SEC, the police and the attorney general. This will ensure proper follow up on all cases.

10. The SEC has also proposed for an amendment to the law on governance. The new draft will spell out clearly the procedures to follow for transactions connected with major shareholders or company executives. Directors' responsibilities will be elaborated, with penalty for failure to act. They can in future be sued both by the companies and the shareholders to recover the gains that they obtained from connected transactions that violate the law.

11. In term of market force, the SEC has also proposed the legislation to allow for class action suits. The small shareholders can more conveniently get together to take actions against the executives for wrong doings. The draft is now with the State Legal Council and should go to the cabinet by the middle of this year. The IOD has also published reports about corporate governance that I encourage to be done every year and to expand to eventually cover all listed companies. The SEC shall also work on encouraging the institutional investors to exercise their judgment in Annual General Meetings more vigilantly than in the past. Among the shareholders, they are the ones best equipped to do the job.

12. The last pillar of self-restraint, or self-discipline, is perhaps what requires the most work. Even though the Stock Exchange has a corporate governance center to give advice, and even though there are quite a few publications regarding this topic, some gaps tended to remain.

Governance Problems in Thailand

13. I shall now talk about some cases of governance problem that occurred in Thailand. I hasten to point out here that, on the whole, the listed companies in Thailand are very well governed. The problems are therefore very concentrated in only a few firms.

14. There is a big difference in governance issue between the developed markets in the West and Asia. In New York, people complain about the imperial CEOs -- the ones who rule their companies as private kingdoms. They over spend. They buy private jets. They launch take over deals more to suit their egos than for good business. They sit on assets that do not generate decent return. They set up poison pills to protect themselves. They are therefore the popular targets of fund managers' actions and complaints.

15. In Asia, it is the other way round. In the West, many companies have shareholders that are widely dispersed, making it difficult to overpower the CEOs. In the East, many companies instead have shareholdings that are too concentrated. Many of them evolved from family companies. But due to lack of long development time, many of them still retain some form of family control. The boards may have independent directors. But often they are friends of the families. In these companies, the rights of small shareholders sometimes come only as an afterthought.

16. In Thailand, we had seen relatively few cases of outright frauds, the type well hidden in the accounts for many years like Parmalat. The cases that I saw were somewhat more open. The most common type involved companies either lending to major shareholders, directly or indirectly, or investing in companies belonging to major shareholders. Eventually, these personal projects failed. Eventually, the companies ended up with bad debts or valueless investments.

17. Another common type was for listed companies to set up subsidiaries to hold valuable assets. These subsidiaries were not listed on the stock exchange. The subsidiaries sometimes had to increase capital, the rights to purchase share of course belonged to the listed companies. Instead of exercising their full rights - - instead of buying all the shares that they were entitled to, they gave up parts or all of those rights. The major shareholders - - or their related parties - - took up these rights instead. These are the typical cases of siphoning money out of the listed companies, into the pockets of the major shareholders. Unfortunately, in most of these cases, the directors presented the deals for shareholders' approval, and surprisingly the shareholders did give the approval too. How and why they should do that I don't know. At the Commission, we think we must try to find ways to stop this.

18. What to do? In the past, the Securities Exchange Commission might have investigated the cases. The Commission might have found that no one could be prosecuted, because the shareholders had already given approvals. The SEC then might have stopped there. Instead today, I plan not to stop. From now on, listed companies that want to call shareholders' meetings in which connected transactions will be voted will have to notify the Commission, with copies of the documents sent to the shareholders.

19. If we see that the analysis is too one-sided, or too difficult to comprehend for the ordinary folks, we shall be the catalyst inciting more analysis and commentaries to be made. Hopefully, it will be like forcing the directors involved to go on stage, under the limelight, to be reviewed and commented by the critiques in the audience. The shareholders' meeting to vote on the connected transactions may also be required to be scrutinized by a third party. A law firm or an audit firm should perhaps also ensure

that the quorum has actually been reached, and that the connected shareholders who have conflict of interest do not exercise their votes.

20. To further enforce the rules and etiquette, the SEC has also set up a Directors Responsibility Steering Group headed by the Deputy Secretary General. The group consists of not only lawyers, but also prominent individuals who understand business practices. Mr. Charnchai Charuvastr, President of the Thai Institute of Directors sitting here is also a member of the Steering Group. This Steering Group will conduct interviews of directors of the companies that the SEC has identified with doubtful transactions. The directors will be invited to explain to the Group their particular reasoning in approving the deals. Why did they see the deals to be beneficial to the companies? Why did they think it was fair to the minority shareholders?

21. Furthermore, from now on the SEC will register names of company directors. If the directors interviewed fail to provide adequate answers to the Steering Group regarding connected transactions and siphoning deals, we may have to consider removing them from the list. I therefore urge all directors to give utmost importance to enquiries from the Steering Group.

22. At the last SEC's board meeting, the board felt that the Steering Group as set up by the Secretary General is going to be an important tool. However, the Board of Commissioners felt that they should enhance this Steering Group by arranging for the appointment to be made by the board themselves, not just by me, the Secretary General. They obviously wanted to change some people in the Group. We shall have to wait until the next board meeting to see the result.

Transparency issue

23. The other important issue is that of transparency. Companies are expected to accurately report on their financial conditions so as to make the directors accountable to the shareholders. On this issue, I have identified two problems.

24. The **first problem** is that related to auditors' opinions. Even though most opinions are well written, some of them are too difficult to read. They either have too many remarks quoted in the opinion page, or some of the remarks look suspected. Having too many remarks means that the important ones are not sufficiently highlighted. Remarks should appear only if they are so important that the accounts may not be properly understood unless those remarks are pointed out. But we also suspect that, in some cases, the auditors may have actually failed to convince their clients to make adequate provision for doubtful debts or diminution in value of investment. The auditors may have gone along with the inadequate provisions, but wanted to protect themselves with the remarks.

25. We therefore consulted with the Association of Accountants and Auditors to ask the auditors to refrain from making unnecessary remarks in the future. In cases where the clients refuse to comply with the auditors' requests to make adequate provisions, for example, the auditors shall qualify their opinions. In such cases, we shall construe the published accounts not to comply with our rules and refuse to accept them. The company will then be in violation of the law. From now on, we want to empower the auditors to do the right things.

26. The **second problem** is that although most of Thailand's accounting standards conform to the international standards, they are open to interpretation. Standards usually deal with generalities. They state the principles of accounting. However, the day to day practices can vary quite a bit from one company to another. The range of grays can be wider than you think.

27. To address this problem therefore, the SEC has also set up the Account Steering Group. This Group consists of not only accounting experts, but also members who can look at the issues through the eyes of shareholders, analysts and the general public. They will recommend to the SEC to consult the Association of Accountants and Auditors on some specific accounting issues. This will make it more difficult to window dress the financial statements, and it will also be the first time the Thai SEC does so.

The Role of Directors

28. Finally, ladies and gentlemen, I have described at length what the Commission has done and will do to try to improve corporate governance. The more interesting question is rather what you as directors can do. This is the part of lunch not being free. We all know the problem. Companies in emerging Asian countries often do not receive the reputation that they deserve. Foreign analysts often see them as opaque, infested with so-called crony capitalism and relying mainly on connections, as if this sort of things didn't exist in the Western market. Thailand also has probably one of the highest concentrations of companies linked to politicians. Therefore doubts may tend to remain about the effectiveness or impartiality of the regulators, as well as the integrity of company directors. We just have to work hard together to change that image for Thailand. The only way to succeed is for the directors to exercise their judgments with utmost care.

29. No amount of rules or codes can absolutely overcome greed and dishonest intentions. Only you, ladies and gentlemen, only you can make the difference.

Thank you.