

Magni Client Commentary

Talking Points on International Governance Research and Investing

April 2016

Country Ranking Trends

- Magni reviewed the protections on the rights of minority investors across the investible countries of the world. Countries where these rights are well protected have better governance and investors will perceive less risk when making equity investments. The review resulted in changes for six countries. Belgium, Indonesia, and the Philippines were downgraded, while Chile, Greece, and Germany were upgraded.
- As mentioned last month, the pace of governance improvements around the world has temporarily stalled. The minor upgrades of three countries mentioned in the prior paragraph does not, as yet, provide sufficient data to indicate that the stall is over.

Roll the Panama Papers into a Need for Transparency in Ownership

- Millions of documents from a Panamanian law firm were leaked to the media, revealing the offshore holdings of 140 politicians and public officials around the world. The leaked data is breathtaking in scope as it covers roughly the last 40 years and over 214,488 offshore entities connected with people in more than 200 countries. The episode may provide the impetus for regulators from around the world to require greater transparency in the ownership of legal entities. The U.S. is a laggard in bringing transparency in the "beneficial ownership" of the firms it incorporates, but a bill now before the U.S. Congress seeks to correct that. The European Union will require member states to maintain central registries of this information for companies formed within their borders.
- Transparency of beneficial ownership is an important factor in Magni's market integrity standard and countries making positive reforms to their incorporation practices would likely see improvements to their Magni Country Scores.

What will Reduce Brazilian Corruption?

- Last month, Magni commentary included information about impeachment proceedings against President Dilma Rousseff. These proceedings continued to move forward and could see her removed from office soon. The ongoing corruption scandal and political turmoil has brought renewed attention to broader issues about Brazilian governance. Throughout its history there has been a tradition of looking to the state as the engine of growth. The resulting expansive government powers, along with opaqueness in many activities, creates an environment conducive to corruption. Magni is not surprised by the many corruption allegations, including six in ten members of Brazil's Congress who now face some kind of criminal investigation. This legacy of poor governance has magnified the scale of the latest deep recession following the boom and bust commodity cycle. The challenge will be to implement necessary reforms at the same time when politicians have such low credibility and lack significant political capital in order to make unpopular decisions like spending cuts.

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- From Magni's perspective, Brazil currently ranks in the middle of the emerging markets. It is just behind Chile and Malaysia, while just ahead of Thailand and Indonesia. Magni will be watching to see if the aftermath of the current scandals creates sufficient pressure to implement the increased transparency and economic reforms required to reduce corruption and put the country on a path to faster and more stable growth.

How Badly will the Constitutional Crisis Hurt Poland?

- As noted in previous months, Poland has a constitutional crisis. Last year's election brought a populist party to power. The new ruling party's early effort to "pack" the country's Constitutional Tribunal was invalidated by a ruling from the Supreme Court. The ruling party has refused to publish the ruling in order to avoid recognizing the invalidation. Poland's top administrative court as well its Supreme Court have both ruled in the past month that the government must recognize constitutional court rulings; *even if the rulings remain unpublished*.
- Magni recognizes Poland as having good governance which was gained since the fall of the Soviet Union. Magni is watching the crisis to determine if Poland will need to be downgraded. Whether the crisis results in a downgrade or not, the ongoing stalemate risks greater and more lasting damage to the rule of law in Poland.

When will Saudi Arabia Emerge?

- Saudi Arabia seeks promotion, by MSCI, to be included in the emerging markets. Currently, its stock exchange is not sufficiently open to foreign investors to meet MSCI requirements for promotion. As one of the most important countries outside the developed and emerging markets, its eventual promotion to emerging markets is likely. Given the current governance in Saudi Arabia, the country would likely receive a Magni Country Score near, but below, average among countries in the emerging markets. Opaqueness, particularly related to government policy and publishing of economic statistics, along with weak protections for shareholder rights, are the biggest opportunities for Saudi Arabia to improve governance.
- Saudi Arabia recently announced its Vision 2030 reform plan, a package of economic and social policies designed to lessen the kingdom's dependence on oil exports. The just announced reforms includes a plan to sell some of the state-owned oil giant Saudi Aramco and transfer ownership of the company to its sovereign-wealth fund. In addition, the company's financial information will be released providing an important test case for reform. Many details of the reform agenda remain to be seen and the greatest challenge will be in the execution, but if economic liberalization can be successfully implemented it would improve Saudi Arabia's ability to attract foreign investment and could serve as a model for other countries in the region.