Consultation with the OECD Corporate Governance Committee

Update of the OECD Corporate Governance Principles

BIAC comments

17 March 2014

I. General comments

BIAC strongly supports corporate governance principles that promote long-term business sustainability and that facilitate the continued stability of capital markets. Good governance contributes to sustainable value creation and is in the interest of companies as it facilitates access to capital as well as increased investor and stakeholder confidence.

Moreover, BIAC believes that business growth should be pursued and managed in an ethically conscious and competitively neutral manner, bearing in mind that there are no one-size-fits-all approaches and that corporate governance practices should be flexible to accommodate the needs of different businesses and stakeholders in different environments.

Corporate governance principles should be regularly assessed to ensure their continued relevance and usefulness for both OECD member and non-member countries, businesses and stakeholders around the world, and ensure that principles retain the capacity to address new business challenges in an evolving global economy. In that light we appreciate the detailed analysis the OECD has carried out over the last years and the summary of the new policy landscape provided in the issues paper (DAF/CA/CG(2014)2). We therefore welcome the fact that the OECD has formally launched the update of the OECD Corporate Governance Principles.

While the proposed changes focus to a large extent on external factors, such as the impact of the financial crisis and structural developments in both financial and corporate sectors, internal factors concerning good corporate governance should be given further attention in line with comments BIAC has submitted previously.

Good governance should support the building of sustainable value in organizations and society, which is an important cornerstone of OECD’s overall mission and the mandate given
to its Corporate Governance Committee. BIAC welcomes the fact that the OECD highlights the link between corporate governance and value creation and underlines that good corporate governance is crucial for ensuring long-term sustainability. Instead of adding complexity, governance codes should be evaluated according to how well they facilitate the creation of value. We, therefore, recommend that sustainable value creation be considered as an overarching objective and guiding principle of the update. Good governance is the foundation for doing business, but needs to provide space for entrepreneurial behavior, fostering longer-term sustainable value creation.

OECD analysis on lessons learnt from the financial crisis should provide important input to the update. In this context, we recommend that the focus should increasingly be on the implementation of governance principles, so that they drive the right behaviors within businesses. There is a clear need to provide structures and transparent procedures to ensure that the Principles are adequately implemented and operate effectively.

While we welcome that the importance of enforcement is highlighted, further attention should be given to specific and practical ways of facilitating enforcement, e.g., using the IPO process for ensuring an adequate basis of corporate governance or, for example, emphasizing governance rating services or indices, or encouraging investors to play a larger role in enforcement. Institutions responsible for enforcement should be able to rely on reasonable funding and be independent from government control.

At the same time, the update process must give due consideration to the risk of over-regulation as a response to the crisis. Over-regulation can be an impediment to economic recovery and could hamper the development of market-driven corporate governance practices. In this context, regulatory impact assessments can be an important tool for understanding the likely impact of new regulation and whether the marginal benefits exceed the costs.

In November 2013, BIAC organized a high-level roundtable with the active participation of corporate governance experts from non-member countries. We welcome and strongly recommend fostering dialogue with non-member countries to ensure that the updated Principles are relevant and useful worldwide.
II. Key issues for the update

On the occasion of the November high-level roundtable, BIAC made several suggestions for issues that should be carefully considered during the update. We are pleased to see that some points have been taken up in the Secretariat's proposal (DAF/CA/CG(2014)3), while BIAC believes that others should be further reinforced. We would therefore like to re-emphasize the points mentioned below:

• **Effective Boards**: Good governance starts at the top. It is therefore recommended to give more prominence to chapter VI and strengthen the text, focusing on the importance of “effective Boards”. Issues such as board composition, including qualifications for director candidacy and developing the Board’s role in risk oversight/management should be further highlighted. Effectiveness should be supported by periodic performance evaluations.

• **We believe all boards should encourage independent and objective views** among their members. However, there are multiple approaches to achieve this depending on the circumstances in different jurisdictions. Some jurisdictions have outside, independent directors, and others include independent points of views through systems of statutory auditors (Audit & Supervisory Board) or advisory councils. In all cases, the independence of thought and objectivity of Board members while making decisions is key to their overall effectiveness.

• **Diversity of thought**: The importance of diversity of thought in the Boardroom should be introduced as a cornerstone of effective corporate governance. This should be done in a broader context of highlighting the importance of skills and experience. Flexibility is necessary in determining what kind of diversity consideration would best suit each company’s unique situation (due consideration to diversity of talent, skills, culture, gender, etc…).

• **Risk oversight and management**: Corporate governance practices should enable businesses to seize appropriate opportunities and manage risks in order to stimulate business growth. The concept of risk oversight and management should be strengthened, taking into account the importance of understanding and agreeing the level of acceptable risk, and the establishment and monitoring of risk policies, frameworks and processes/practices. Whether a committee is required at the board level to manage risk may be driven by the nature and complexity of the company’s business and related risks, and the particular circumstances in different jurisdictions.

• **Audit committees**: Since the Principles were revised in 2004, independent audit committees have played an increasingly important role in enhancing confidence in corporate reporting. The discussion of the audit committee, as well as global standards in auditor independence, should be highlighted to reflect current practices. For example, since 2004, jurisdictions around the world have put in place robust independence standards, including many that have implemented independence and ethics in alignment with the Code of Ethics of the International Ethics Standards.
Board for Accountants (IESBA). We therefore support the elevation of audit committees from the annotation to the Principles.

- **Disclosure and transparency:** The Principles should acknowledge the developments we have seen since 2004, among others in corporate reporting, including on non-financial information that is beneficial to stakeholders. However, it should be born in mind that a balance needs to be found between the additional costs for companies connected with complex reporting requirements and the benefits of providing additional information.

- **“Comply or explain”** is an important foundation of the flexibility of national corporate governance codes, which should be duly highlighted. This implies that companies can achieve good corporate governance by either applying the code or by explaining why they chose not to do so, bearing in mind that the reasons for not doing so should be explained clearly and carefully to shareholders, who, if they consider the explanations as insufficient, can then vote against the company resolutions. We support this approach: a high level of transparency on corporate governance information by companies, accompanied by the means for shareholders to hold Boards accountable for their corporate governance decisions and disclosures. We believe this approach has a stronger chance of success than a heavy legislative approach.

- **Shareholder rights:** We recommend further emphasis on addressing cross-border voting impediments, enhancing transparency regarding disclosure of beneficial and derivative ownership and respect of minority shareholders.

- **Rights and Responsibilities of institutional investors:** We believe the issue of shareholder behaviour and investor engagement (or: “stewardship by institutional investors as intermediaries”) should be emphasized in the Principles. We also support consideration of what the governance framework should provide for stakeholders beyond a company’s equity shareholders. We encourage the OECD to investigate the incentives for investors to monitor and engage with their investments, and ways to minimize misalignments between investors and companies where they invest.
III. Selected initial comments on the proposed Secretariat changes

Bearing in mind that further discussion will be necessary within our wider membership on the Secretariat’s proposal, which was issued at the end of February, we would like to offer the following initial comments on selected proposals that have been made. These comments should be read in conjunction with the above-mentioned key issues for the update. They will be complemented by additional specific comments in the course of the update process.

Requirements for large listed companies:

The revision reserves a number of requirements only for larger companies. Among these, requirements for disclosure about the system for monitoring and managing risk, internal audit systems and audit committees of the board. A differentiated corporate governance approach based on size may look appealing. However, it could become a barrier when companies pass a certain threshold that would oblige them to adapt to a more extensive corporate governance framework. Such an approach may also send an unhelpful message that good corporate governance is only for larger companies. A principles-based framework, together with a “comply or explain” provision should provide sufficient flexibility for smaller entities.

Disclosure and transparency

The proposal to remove interim reports would be the wrong approach to discourage short-termism.

A3: The disclosure wording on major share ownership should be strengthened.

V.A.4: The issue of remuneration policy and board independence should be separated.

C: Internal audit systems should not only apply to large companies, but all public companies (see above)

Related party transactions

The revisions indicates that “…it is essential for the company to fully disclose material related party transactions, individually and including the terms at which they have been executed. The execution at arm’s length and on normal market terms should be a legal requirement.”

While BIAC agrees with the importance of related-party transaction disclosure, we believe these changes should be consistent with international financial reporting standards. Moreover, they should be consistent with existing transfer pricing standards, which minimize disclosure of sensitive information. Moreover, to the extent the revision may impact tax rules,
this should be well-considered and addressed in consultation with the OECD tax committee. BIAC believes that a fundamental change in tax rules, as this change may indicate, should not be included in a document on corporate governance alone.

Remuneration:

The revision mentions that “shareholders should be able to make their views known, including through votes at annual shareholder meetings, on the remuneration policy and packages for board members and key executives. They also call for the disclosure of the remuneration policy of members of the board and key executives.”

Remuneration schemes should be encouraged that contribute to achieving the longer-term objectives of creating sustainable value. BIAC agrees that remuneration policy should be transparent and aligned with long-term objectives and should be formulated in a way that it drives behaviour of senior executives according to shareholder objectives. However, the absence of vote on remuneration policy does not mean that shareholders are necessarily deprived from expressing their point of view. There may be more than one way to canvass the views of shareholders without enforcing a vote. For many companies, the difficulties of putting a vote in place on individual remuneration should not be underestimated.

Taxation (p. 31-32)

According to the OECD Guidelines for Multinational Enterprises, complying with the spirit of the law means discerning and following the intention of the legislature. It does not require an enterprise to make payments in excess of the amount legally required pursuant to such an interpretation.

The wording “nor should it be interpreted as generally requiring companies to minimize their tax bills” is problematic as the section discusses broad principles and then singles out tax explicitly.

The reference to the OECD BEPS Action Plan as providing important orientation in the area of tax governance seems confusing and inconsistent with the issues being addressed in this section. It is not clear if the BEPS Action Pan would deliver principles that could be specifically addressing corporate governance purposes. Until then, we believe this reference to the BEPS project should not be included.