



Public consultation: OECD Corporate Governance Principles

BIAC COMMENTS

2 January 2015

BIAC is pleased to submit the following comments to the public consultation on the OECD Draft Corporate Governance Principles. In addition to the overarching comments and key comments on individual chapters, we would like to refer to the many detailed wording changes which we submitted in October, many of which remain relevant for the latest draft. We hope that our comments can be taken into account, and we look forward to remaining actively involved going forward.

Overarching comments

- BIAC would like to reiterate its strong interest in making the Principles as effective as possible. They must promote a long-term perspective, foster entrepreneurial behaviour, allow for the ability of companies to take risk and contribute to longer-term value creation. At the same time, and bearing in mind the importance of overarching Principles, they must be able to accommodate different needs of companies. There is **no one-size-fits all, but there is no “free for all”** either.
- Good governance is fundamental to the effective functioning of the world’s capital markets and to companies in creating sustainable value. The corporate governance framework should be developed with a view to its impact on overall economic performance, market integrity and the incentives it creates for market participants and the promotion of transparent and efficient markets.
- The objective and main target group of the Principles should be clearly communicated. They are Principles, not regulation. They are directed primarily to policymakers, regulators and market participants to **enable an environment for good corporate governance**. The overall focus should therefore be on **desired outcomes**, rather than including too many detailed prescriptions which differ in the various jurisdictions and can change quickly, bearing in mind that corporate governance is an evolving concept. It might therefore be advisable to focus on overarching high-level principles and refer to other sources of guidance and standards in the text to ensure that the Principles remain relevant over time and applicable in different jurisdictions.

- We are encouraged by a number of the changes that have been made, although in a few areas, we would recommend additional details, including for example the responsibilities of the board in the **oversight** of the company's risk management process.
- We also continue to believe that the current **auditor independence** section is not strong enough, given the critical importance of independence to audit quality and investor confidence. This is an example of an area where a principles-based approach that is focused on key issues and needed outcomes would be beneficial. We would therefore like to reiterate our specific comments submitted earlier regarding chapter 5 to further highlight the importance of the audit committee and its oversight of auditor independence. In this context, we recommend dropping the reference to “large companies,” particularly where related to the audit committee. Neither audit committees nor periodic board evaluations should be limited to large companies. While investors in every publicly listed company would benefit from an audit committee, in some smaller companies, it may be feasible to discharge the duties of the audit committee by the Board itself. What is important is that the oversight missions allocated to the committee are performed.
- With regard to **other OECD instruments**, such as the OECD Guidelines for Multinational Enterprises (MNEs), for example, we recommend including a reference up front rather than overloading the Principles with detailed considerations in individual chapters, which would risk making them too complex. The same applies to **human rights** issues, which are duly reflected in the MNE Guidelines and could be referred to at the very beginning rather than in individual chapters.
- We have noted that increased attention is given to **institutional investors** and would like to underline again the need for close dialogue with and active engagement of investors to minimize misalignments between investors and the companies they invest in. Changes to equity markets could be more fully reflected building on the excellent work that has been carried out in the area of the value creation project.
- With regard to the sections on **remuneration**, it should be clarified that the term “key executive” is limited to board members, including executive board members who have been appointed and not to high-level employees. As mentioned previously, we caution against a general vote on individual remuneration packages. An opportunity for discussion and voting should be provided when the remuneration system changes.
- BIAC recognizes that corporate governance principles extend to the area of **taxation**. It is essential that the revised principles are in line with the related language in the 2011 MNE Guidelines and consistent with the work by the Forum on Tax Administration. Additional comments from BIAC tax experts are included in the comments hereafter on the board chapter.

Additional comments by chapter

These comments should be read in conjunction with the text-specific comments and questions for clarification BIAC submitted in October, which remain valid and should be considered.

I. Ensuring the basis for an effective corporate governance framework

- We welcome the inclusion of “comply or explain” in the first chapter. “Comply or explain” is an important foundation of the flexibility of national corporate governance codes. We believe this approach has a stronger chance of success than a heavy legislative approach. The value of voluntary codes, which are aimed to strike a balance between effective guidance and entrepreneurial flexibility, should be duly highlighted.
- It should be underlined that good corporate governance is equally important for non-publicly listed companies. With regard to the principle of “proportionality” and taking into account the size of the company, introduced in para 3, we would like to note that while a differentiated corporate governance approach based on size may look appealing, 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. Furthermore, it should be stressed that the application of Corporate Governance Principles should take into account not only the size of a business but also the complexity of its operations (e.g. banks and financial institutions).
- In para 5, which refers to the fact that enforcement can also be pursued through private action, we suggest adding “including mediation”.
- The section on stock markets is more explanatory than principles-based. There should be further elaboration on how stock markets can better support corporate governance. It could also be pointed out that when stock markets are over-regulated, this can lead to corporations pulling out.
- Para 11 related to supervisory, regulatory and enforcement bodies should also refer to the need to be “made independent from political influence.”
- As a general comment, it should be noted that good governance is also important for non-publicly listed companies.

II. The right and equitable treatment of shareholders and key ownership functions

- Concerning the various references to vote on the remuneration of board members and key executives, BIAC had previously cautioned against a general vote on individual remuneration packages and had underlined that the focus should be on “remuneration policy.” The various references to remuneration **policy** should be kept in. We also recall the importance of clarifying what is meant by “key executives.” It should be clearly understood that it is limited to board members including executive board members who have been appointed and does *not* refer to high-level employees generally. As mentioned previously, we caution against a general vote on individual remuneration packages. It should be sufficient to provide the opportunity for discussion and voting when the system changes.

BIAC agrees that the remuneration policy should be transparent and should be formulated in a way that it drives behaviour of senior executives according to the long-term strategic objectives of the company. However, for many companies, the difficulties of putting a vote in place on individual remuneration should not be underestimated. These comments also apply to other sections in the Principles.

- For B3 we suggest: “extraordinary transactions **involving** the transfer **or sale** of all or a **substantial part of** the assets.”
- With regard to the call for shareholder approval on material changes to existing schemes (para 23), this should be further clarified. Shareholders should not vote on technical aspects which would further broaden the scope of the meeting. It should also be noted that immaterial changes do not need to be subject to further approval, in consideration of the time and cost this would require.
- At the end of para 27 it should be underlined that to provide clarity for shareholders, regulators should issue guidance on forms of coordination and agreements that do not constitute such acting in concert in the context of takeover rules.
- In relation to Principle E, we recommend inserting reference to “significant influence.” Certain shareholders may not have control but are still capable of disproportionately influencing company affairs and decision-making.
- With regard to related-party transaction (RPT), conflict of interest inherent in those transactions should be adequately addressed, including through proper monitoring and through full and timely disclosure. However, it should also be noted that many jurisdictions that require shareholder approval on RPT have other or additional requirement than the fact that the RPT is “material”.

As mentioned in our earlier comments, we caution against provisions that are too detailed and do not fit with the various company law systems in OECD countries. With regard to the sentence on shareholder say in

approving certain transactions (para 35), we had previously requested deletion. In some jurisdictions, there are other ways of protecting minority shareholders from abusive RPT, which should be equally recognized.

III. Institutional investors, stock markets and other intermediaries

- We appreciate the inclusion of a chapter on institutional investors, recognizing their important role, but generally believe that some of the language could be made more principles-based.
- In the section on stock markets, it should be recognized that there is more that stock markets can do to further good governance. This paragraph could be broadened.

New specific changes proposed in this section (not included in our previous submission):

- Para 42, last sentence: delete “the incentives and”
- Para 43, first sentence: delete “and many of their assets are managed by specialized asset managers” delete “and lead to a box-ticking approach” at the end of the last sentence
- Delete at the end of the point A “especially where an institution has a declared policy to vote”
- Para 45: Second sentence should read: “While this principle does not **generally** require institutional investors to vote their shares, it calls for disclosure of how they exercise their ownership rights, **after** due consideration to cost effectiveness.”
- Para 47: delete “to justify management fees”
- Para 48, second sentence “Rules should require custodians institutions to provide shareholders with **timely** information...”
- Para 52: delete second sentence “such actions may include...”
- Para 59: delete second sentence “When they believe...”

IV. The role of stakeholders in corporate governance

- As mentioned previously, point E should be clarified as the word “concerns” is overly broad. Due attention should be given to company-internal procedures.
- We recommend that the MNE Guidelines be best addressed in a general reference in the introductory section of the Principles.

V. Disclosure and Transparency

- Recognizing the many developments in this area, it might be worthwhile to be less specific in this section, and rather focus on underlying principles (e.g., the importance of timely disclosure of material information) and refer to other sources that are at the forefront of good communication and consultation.
- We suggest that consideration be given to referring to International Financial Reporting Standards (IFRS) with respect to financial reporting, International Standards on Auditing (ISA) with respect to audit and the International Code of Ethics for Professional Accountants when discussing auditor independence.
- We recommend deleting the new addition on “human rights, including where relevant within their supply chain,” from para 76 regarding disclosure policies. Human rights issues would best be added in the context of the reference to the OECD MNE Guidelines at the beginning of the Principles. In addition, global supply chains are often extremely complex so that it is impossible for companies – especially SMEs – to control or report on the whole supply chain. Supply chain issues are already addressed in the OECD MNE Guidelines (referenced earlier in the Principles), which are the flagship OECD instrument for responsible business conduct, recognizing that the encouragement of business partners is subject to practical limitations depending among others on the complexity of the supply chain.
- With regard to the section on political donations (para 77), the obligation to disclose donations should be primarily on political parties and candidates, which would equally inform citizens about funding from the range of contributors.
- Disclosure of ownership data should be provided once **important** thresholds of ownership are passed (para 78). In paragraph 78, we suggest adding “significant influence”.
- In line with our earlier comments, we believe that the text on auditor independence (V.C) should be strengthened, given the critical importance of independence to audit quality and investor confidence. It would be helpful to have additional emphasis on why auditor independence matters, focus on the governance mechanisms overseeing auditor independence and avoid a long list of policy approaches that may be appropriate in some markets but not in others. In this same section, we would like to reiterate the edits submitted in October to more accurately describe the role of the audit and the auditor’s report. The reference to “large companies” should be dropped, in particular where related to the audit committee.
- In line with our earlier specific comments, please find below a clean version with our comments incorporated of the section on auditor independence:

V.C. An annual audit should be conducted according to international standards on auditing by an independent, competent and qualified auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.



93. External auditors play an essential role in the public interest in upholding investor confidence in a company's financial statements. The objectives of the auditor are to obtain reasonable assurance that the financial statements are fairly presented and are free of material misstatement due to error or fraud and to express an opinion in the auditor's report. Under international standards on auditing, the auditor should also report on key audit matters, those areas of the audit that demanded most significant auditor attention. In addition, in some jurisdictions, auditors also express an opinion about whether the company's financial reporting processes and internal accounting controls are appropriately designed and operating effectively. This should contribute to an improved control environment in the company.

94. Due to the significance of this role, the external auditor should be required to be independent in both fact and appearance of the company being audited. Investor confidence requires independence requirements that are robust and enforceable. These requirements should address the primary threats to auditor independence. The IOSCO Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence states that, "standards of auditor independence should establish a framework of principles, supported by a combination of prohibitions, restrictions, other policies and procedures and disclosures, that addresses at least the following threats to independence: self-interest, self-review, advocacy, familiarity and intimidation." Jurisdictions have taken different approaches to address these threats but in all cases auditors should not be permitted to compromise their objectivity or professional integrity.

The designation of an audit regulator independent from the profession, consistent with the Principles of the International Forum of Independent Audit Regulators (IFIAR), can be an important factor in improving audit quality.

95. The audit committee or an equivalent body should provide oversight of the internal audit activities and should also be charged with overseeing the overall relationship with the external auditor including the nature of permissible non-audit services provided by the auditor to the company. The audit committee should report to shareholders on how it carries out its oversight of the external auditor, including on the auditor's independence and effectiveness. Such reports should include its policy on the approval of permissible non-audit services provided by the external auditor and the disclosure of payments to external auditors for approved non-audit services.

96. An issue which has arisen in some jurisdictions concerns the pressing need to ensure the competence of the audit profession. A registration process for individuals to confirm their qualifications is considered good practice. This needs, however, to be supported by ongoing training and monitoring of work experience to ensure appropriate levels of professional competence and an understanding of internationally accepted auditing standards and practices.

- There is also a need to correct the language on an auditor’s duty of care. Whether an auditor owes a duty of due care to shareholders (see addition in para. 97) is a matter of local law. We recommend reverting to the language of the 2004 version of the Principles. The addition of shareholders to the auditor’s duty of care must be dropped.

VI. The responsibilities of the Board

- As mentioned previously, we consider this chapter as particularly important and had raised the question why it comes at the very end. We suggest that the chapter focus on effective boards and their responsibilities. As mentioned for the previous chapter, there have been many developments in this area. It might therefore be better to refer to key sources that are at the forefront in this area.
- The purpose of para 110 should be clarified. Why does it only deal with two-tier boards?
- In para 117 on compliance, with regard to the addition related to “as well as relevant international agreements...” it should be born in mind that in many jurisdictions, international treaties and agreements only become binding when they are transformed into national (or supra-national) law. We suggest adding the following sentence: “Effective compliance and internal controls systems require “up-the-ladder” reporting lines for compliance and internal control personnel to the responsible management and a regular reporting of compliance and internal control risks to the board by management.”
- Audit committees and periodic board evaluations or an internal audit function should not be limited to large companies. The reference to “large companies” should be dropped (VI.D.7, para 127, E.4).
- Where language is inserted about the board’s role in oversight of the company’s risk management process, the wording should be carefully chosen to not suggest the board is responsible for managing risk but rather is responsible for the oversight. The language should reflect the expectation that the board will ensure adequate and effective risk frameworks, risk appetites, policies and processes and reporting requirements are in place. At the same time, a silo approach with regard to risk management should be avoided.
- With regard to VI.D, boards should be encouraged to provide periodic reports to shareholders on how they are carrying out their responsibilities, including through the work of their committees.
- In para 129, we support emphasizing the need for directors to be professional and continually upgrade their knowledge and skills in corporate governance.
- In para 132 regarding employee representation on boards, we recommend making a specific reference to the duty of confidentiality among the duties of employee representatives on the board.

Comments on tax aspects in chapter VI

BIAC recognizes that corporate governance principles extend to the area of taxation. The issue of taxation and corporate governance was included in the revised 2011 OECD MNE Guidelines, and has been a focus point of work by the Forum on Tax Administration. It is important that the revised OECD Principles of Corporate Governance are consistent with this work.

The following are comments on the revised text referring to tax:

Paragraph 104:

Paragraph 104 discusses ‘duty of care’ and states that *“the duty of care does not extend ...[...]. to an obligation to pursue aggressive tax avoidance.”*

We believe that it is inappropriate to include a reference to ‘aggressive tax avoidance’ in this paragraph, as this concept cannot be compared to ‘due diligence’ and ‘gross negligence’ also mentioned in that paragraph. Those two terms have well understood legal meanings, but ‘aggressive tax avoidance’ does not have an agreed legal meaning. To include a reference to ‘aggressive tax avoidance’ confuses a paragraph that otherwise contains an important and well-understood statement.

If the OECD does decide to include text on the interaction between ‘aggressive tax avoidance’ and the ‘duty of care,’ it first needs to define that term, and then needs to state explicitly the nature of the duty of care.

We propose deleting the phrase relating to ‘aggressive tax avoidance’ (see below):

“In nearly all jurisdictions, the duty of care does not extend to errors of business judgement so long as board members are not grossly negligent and a decision is made with due diligence etc., ~~or to an obligation to pursue aggressive tax avoidance.~~”

Paragraph 106:

Paragraph 106 discusses board level oversight of the tax function, and the boundaries within which the tax function is permitted to operate. We believe that this paragraph could be improved to clarify the practical interactions between the board and the tax function. We suggest the following wording, which more closely reflects MNEs good corporate governance practices:

“Similarly, jurisdictions are increasingly requiring that boards provide a tax oversight role, to ensure that the tax function operates in accordance with the wider corporate governance objectives of the

organisation. Such principles should ensure that the tax planning practices are sustainable, and contribute to the long term interest of the company and its shareholder (including taking into account legal and reputational risks where appropriate)."

This is an important area where standards are still evolving. We believe that with more precise drafting these principles can play an important role in that evolution.