Consultation with the OECD Corporate Governance Committee

BIAC comments on future OECD work

Implementation of the OECD Corporate Governance Principles

BIAC was actively involved in discussions on the update of the OECD Corporate Governance Principles, which were adopted by the OECD Council in July 2015 and subsequently endorsed by G20 Finance Ministers in September. The G20 endorsement was a major step forward to further raise the visibility and status of the Principles as a key instrument with broad international coverage. Now the focus must be on dissemination, adoption, monitoring and implementation, while at the same time anticipating future trends and including them in work going forward. We encourage the OECD to make greater use of technology (webcasts, podcasts, etc.), to complement the meetings and roundtables which are being organized, allowing peer to peer networking and the exchange of experiences.

The implementation of the Principles should be the top priority of the Committee going forward, including both country-specific and horizontal peer reviews and analysis. There is a need to consider cultural differences between jurisdictions, noting that one size does not fit all and that capacities differ. The investment community needs more information on emerging markets, so greater emphasis should be placed on peer review of G20 emerging market economies.

Thematic reviews could focus for example on developments in risk governance practices, beneficial ownership initiatives, and how individual countries are tackling the need for better corporate governance culture in companies. We also recommend looking at gaps between corporate governance regulations, principles and codes and their implementation. Issues to be considered in thematic reviews could include, among others, the important issue of board independence, which is particularly relevant in view of current discussions at the national level, board composition, succession planning and evaluations. It would also be helpful to consider what has changed in the area of monitoring and enforcement and disseminate best practices to OECD member as well as non-member countries.

As part of the follow-up to the Principles, the OECD might also wish to look at specific issues which BIAC mentioned earlier, including, but not limited to the following:

- **Addressing the risk of over-regulation:** Over-regulation and overlapping regulations can be impediments to economic growth and hamper the development of market-driven corporate governance practices. The OECD can make a useful contribution by addressing this issue, giving careful consideration to situations where regulation may be contrary to recommendations in the Principles, and by fostering cooperation between OECD corporate governance and regulatory policy experts.
• **Reporting and disclosure requirements:** While it is recognized that disclosure and reporting need to go beyond financial reporting, the additional costs for companies, including for smaller companies, connected with complex disclosure and reporting requirements should be carefully considered and weighed against the benefits of providing additional information and the confidence it engenders in investors. The OECD should help shed further light on this issue.

• **Institutional investors:** We appreciate the increased focus on institutional investors in the updated version of the Principles. We underline the importance of institutional investor engagement and encourage the OECD to investigate the incentives and obligations for investors to monitor and engage with their investments, ways to minimize misalignments between investors and companies where they invest, and consider the role of stewardship codes.

• **Skills:** The importance of a balanced team of directors with the right skills sets is widely recognized. Based on the outcome of the BIAC skills roundtable in 2015, the OECD could play a useful role by sharing best practice on obtaining and continually enhancing the right mix of director skills. The “skills agenda” is also in line with the OECD work on New Approaches to Economic Challenges (NAEC).

**Data and analysis**

One of OECD’s key strengths is the collection and compilation of fact-based information, which is of great value to business and policy makers to ensure that discussions are based on objective data. We support the expansion of the Factbook and encourage inclusion of all G20 countries and other partner countries in the analysis. We support the proposal to continue to update the Factbook on a regular basis, including with results from the peer reviews. Suggestions for areas of further development are: corporate practices to develop a corporate governance culture, stock market practices to encourage corporate governance, including the role of the audit committee, and how the stock exchange itself maintains and builds its stock exchange corporate governance reputation.

The OECD program of work underlines the importance of multi-disciplinary work. Linkages to other OECD activities should therefore be explored. While the OECD is looking separately at public sector governance, it is important to not lose sight of the applicability of good governance in the public sector. In considering multi-disciplinary work at the OECD, the important link between governance and behaviour, and issues such as the fight against bribery and corruption could also be considered.

**The role of the creditor**

As providers of risk capital, both creditors and shareholders are exposed to the residual risk of companies they invest in, and debt tends to be a permanent form of capital in most companies—even if individual debt issues are serviced and then reissued. Sustainable and healthy companies should have cost effective access to both debt and equity, and boards should ensure that company governance mechanisms reflect a fair and appropriate balancing of shareholder and creditor interests. The creditor’s perspective on corporate governance can be critical, particularly for banks, which can be 95% creditor funded—and where regulatory developments have resulted in senior
bank debt with “bail-in” in provisions that in some ways make it indistinguishable from preferred stock.

It is also the case that creditors holding long-term (and often less liquid) debt instruments share with shareholders an interest in a company’s long term successful corporate governance practices – even though they may define corporate governance differently. While the interests of creditors and shareholders can be different – and potentially hostile—when a company is approaching insolvency, they can also be complementary for companies.

Based on previous research, there is scope for further enhancing the understanding of the role of the creditor in corporate governance and to explore areas of commonality and difference with shareholders with regard to corporate governance matters. This topic features in OECD corporate governance reports and from an investment perspective it also extends to how fixed income investors should factor governance related issues into investment analysis and stewardship activities. BIAC would be pleased to discuss possibilities of further dialogue with the Corporate Governance Committee in this area.

**OECD assessment methodology**

The development of a coherent analytical framework is essential to support ongoing dialogue and implementation of the OECD recommendations to demonstrate which countries have to make improvements and where. As the updated Principles contain a number of changes compared to the previous version, the review of the assessment methodology is clearly a priority. Due attention should be given to the importance of new developments and techniques in monitoring the implementation of corporate governance recommendations as well as to the development of a self-assessment toolkit.

We are supportive of the focus on assessing outcomes and the recognition that there is no ‘one size fits all’ in relation to delivering good governance. The framework must allow for flexibility as companies come in various sizes, degrees of complexity and stages of development. However, the methodology does seem very detailed for an analysis which will be based on judgements of outcomes. The assessment of corporate governance and the outcomes is often qualitative and judgemental and a methodology described in such detail could imply more precision in the analysis than might be possible to achieve.

Given the length of the methodology, consideration could be given to organizing the document in a way that would facilitate reviewers/assessors concentrating on principal consideration. Appendices (or links) might prove helpful in this context. Language should be carefully checked, e.g. the frequent use of the word “likely”, which might facilitate the potential for an unhelpful diversity of interpretation, “criteria” and “essential criteria”, etc.

The methodology recognizes the difference between hard law and regulation and the use of codes and notes that either can be effective. With regard to enforcement, if the requirements are defined by hard law, it is necessary to have a strong enforcing regulator that will ensure companies meet the standards. Codes require others to hold those to account to who codes apply. The type of investor environment in a country is important to the enforcement of codes.

We underline that the quality of the reviewers/assessors is most important. While paragraph 18 refers to accountants, auditors, board members, etc., it should also refer to the need for expertise in
corporate governance assessment itself. The experience, understanding and judgement of those who are doing the reviews are critical, also requiring a thorough consultation process.

We suggest updating the sections related to auditors and board committees to reflect leading practices that have emerged over the past 10 years. In particular, we suggest expanding the text relating to audit committees and their role in overseeing the external and internal audit, reflecting the importance of this type of governance structure to investor protection and auditor independence.

These additions would provide assessors with more complete information to evaluate how well a jurisdiction is implementing the Principles. Providing additional information is particularly important with regard to audit-related issues, which are critical to strong corporate governance but might be less known to some assessors. In certain places, the Methodology’s current descriptions of the role of the auditor or the regulations and codes that typically apply to auditors are either unclear or imprecise. We suggest clarifying these areas to enhance assessors’ understanding of the related provisions.

We also suggest adding more references to other relevant international codes and principles to provide assessors with more tools with which to analyze different aspects of a jurisdiction’s corporate governance framework. For example, since the previous version of the Methodology was published, the International Forum of International Audit Regulators (IFIAR) has grown from 17 to 50 members and has developed its own principles regarding independent auditor oversight. Although the IFIAR principles are mentioned in the draft revisions to the Methodology, we suggest providing additional references to the IFIAR principles in relevant places to call assessors’ attention to them as a resource.

Principle I.D underlines that stock market regulation should support effective corporate governance. Stock markets should have a full range of investigation and enforcement mechanisms available so as to impose appropriate penalties. However, supporting effective corporate governance by stock markets implies much more than establishment of requirements and enforcement of these. Many corporate governance expectations cannot be ‘required’ or ‘enforced’ and so stock markets also should develop a monitoring role and methods to sway the markets where regulation and enforcement are not available to it. Comments in the methodology regarding Principle I.D should indicate there are formal and informal approaches to establishing and ensuring corporate governance requirements and expectations are fulfilled.

**Additional specific comments on the methodology**

**Paragraph 7** notes that the fact that the methodology is based on jurisdictions, rather than individual companies, creates challenges. That is true, but the challenges are created as much by the fact that the Principles are similarly constructed – that is, a combination of jurisdiction and individual company requirements and expectations.

In **paragraphs 43-46**, it is important to consider the perspective that one regulator or oversight body should not have sole responsibility for setting rules, interpreting rules, inspecting compliance, enforcing the rules, and judging and punishing when rules are not complied with. There should be a right of due process and appeal to an entity other than the regulator or oversight body.

In **paragraphs 102-107**, greater consideration should be given to the role of technology in assessing whether this principle is met.
BIAC endorses the general approach taken in the methodology of Principle II.F outlined in paragraphs 129-132. However, where ex ante board approval is required for material RPTs, it should stipulate that ‘board approval’ should be by ‘independent and non-conflicted board members only’. Furthermore, some RPTs may be so material to the business that they should require shareholder approval. This should be included here.

Chapter III of the Methodology could be enhanced by referring to the number of Guidelines on expectations of investors, especially institutional investors, issued by the International Corporate Governance Network (ICGN), the global network of investor organizations (e.g., 2015, Institutional Investor Responsibilities; 2014, Global Governance Principles; 2012, The Model Contract (between Asset Owners and Asset Managers) and 2016, Global Stewardship Principles). We also draw attention to the GNDI, the Global Network of Director Institutes. Both organizations maintain guidance for investors.

In paragraphs 179-182, greater consideration should be given to the cooperation and liaison between securities regulators in different jurisdictions in assessing whether this principle is met.

In paragraphs 217-220, it would be beneficial to refer to the various non-financial information reporting frameworks and standards.

In paragraphs 252-267, the framing of these sections should be carefully considered. Those performing an assessment using the methodology should not be led to unequivocally believe that any decision or activity by a regulator is by definition regarded as being in the public interest (para. 257); regulators and oversight organizations are not subject to undue influence and conflicts of interest that must be guarded against and checked. For example, independent standard-setting and audit oversight bodies must not only be independent of the profession, but also from other undue (especially political) influence (paras. 260 and 267); standard-setting can only be enacted in the public interest by having an independent oversight body (para. 258) – failing to recognize the importance of due process and other checks and balances; enforcement by the accountancy profession is only referenced in a manner suggesting that it has failed to meet expectations (para.256); and that there is no high-quality, internationally-accepted code of ethics for professional accountants, including auditors; as the IESBA Code of Ethics is not referenced.

When reference is made to the fact that the international organizations can better assess adoption and implementation of high-quality reporting standards, the names of the other international organizations are not included (e.g., IFAC, IASB, World Bank, etc.) and no comment is made about the importance of liaising with them.

In paragraphs 337 and 340, it should be considered whether reference should also be made to whistle-blowing arrangements, including those established by organizations themselves.