May 2020

Thought starter
Corporate Governance in the COVID-19 response

In the midst of the greatest economic and health crisis the world has seen in many years, good corporate governance, as underlined in the OECD/G20 Corporate Governance Principles, is of crucial importance. It is not only essential for the short-term survival and recovery of business, but also to ensure preparedness for potential future crises, enhance maximization of enterprise value in the longer term and ensure trust in business.

As responding to the COVID-19 crisis has become an overarching priority for the OECD, we appreciate that the Corporate Governance Committee is organizing a roundtable on corporate governance and market oversight initiatives related to the COVID-19 outbreak to discuss key corporate governance provisions that have been or may be impacted by the pandemic. While in no way an exhaustive list, we would like to draw members' attention to a number of issues that have arisen in the current context. We believe that the OECD can play a substantive role by documenting temporary measures introduced across OECD countries in the context of COVID-19, including timelines of how long such rules would be in place, starting with selected countries and sharing information with the committee.

Capital & the efficiency of the capital markets

While most of the attention of policymakers currently focuses on whether companies can borrow to ensure their survival, it is already clear that quickly raising equity and long-term debt could be a lifeline for many companies. For this purpose, policymakers should consider the opportunity of adapting company law and capital markets rules to this unprecedented emergency, by enabling companies to rapidly raise capital on the market.

As a matter of fact, this is already happening in some OECD countries, while others still lag behind. Hence, we would encourage the OECD to track developments in this area and to provide a general overview of the key elements of these interventions, such as the relaxation of rules limited to a specific time span. These measures can play a fundamental role in ensuring capital markets remain effective in supporting companies during such a challenging time.

For the same purpose, we support an OECD impact assessment of rules governments have introduced aimed at reducing dividends and share repurchase programs. While these rules often reflect a societal desire for fairness in the context of state aid and guarantees, a global overview of these provisions and a comprehensive evaluation of their possible cumulative effect could help policymakers in understanding whether they could have a systemic effect on the efficiency of capital markets.

Insolvency

In times of financial uncertainty, it is important for directors to understand the financial position of the company and assess whether it can pay its debts as they become due and payable. Company directors should continuously monitor the performance of a company, through keeping proper books of account to the extent possible, to enable them to ascertain the financial position and take decisions accordingly. If a company cannot meet its obligations, it is likely to be insolvent and if continuing to trade while insolvent, directors may become personally liable for company debts incurred and the company could be breaking the law. In several countries, regulators have given business a safety net and reduced the risk of personal director liability for company debts.

We suggest that the OECD tracks the effect on corporate governance of new measures, including on shareholders' and creditors' rights, and ensures a later return to the original regulations. We also suggest that the OECD tracks what regulators consider to be 'sufficient disclosure' for directors that they may access 'safe harbor' provisions when facing insolvency in the new circumstances.

Debt and creditor issues

Governments, companies and households experienced high levels of debt already before COVID-19. Now, with COVID-19, a protracted economic contraction, and credit support from the government, it is possible that debt restructuring will become more common in the near to medium-term. Companies may find it challenging to manage old and new creditors and may have to demonstrate that the support funds offered are indeed used for the purpose stated – to ensure business continuity. The OECD could help track the impact of public credit support on existing shareholders and creditors and on company decision-making.

Financial reporting and accounting implications of COVID-19 disruptions

There are several practical challenges presented by COVID-19 that impact companies' ability to produce timely, reliable, insightful information. There is an ecosystem surrounding financial reporting, and all parts of it must adapt -- managements, audit committees, regulators, policy-makers, standard-setters, investors, and auditors. As a result of COVID-19, some companies will be unable to complete the financial reporting process in a timely manner. Given the disruptions and uncertainty, managements must exercise significant judgment when preparing financial statements, they may be distracted by the crisis, and as a result they may be unable to give financial reporting sufficient attention. Auditors may have difficulty gaining access to inventory counts and other evidence needed to complete an audit, or even to company personnel and records to conduct the audit.

13-15 Chaussée de la Muette, 75016 Paris, France
Tel: +33 1 42 30 09 60
contact@biac.org | businessatoecd.org

While extended deadlines in some countries are welcome, some companies' financial statements may be delayed. Delayed or absent audit reports may have second-order effects on everything from securing expected financing, meeting debt covenants, and even on derivative trading. In addition, liquidity and cash-flow problems, difficulties in predicting future consumer behavior, supply chain disruptions and the general collapse in demand may signal to investors that we may see an increase in company failures over the short to medium term. Particularly helpful have been public statements and guidance issued by some regulators, which recognize the uncertainties in the current business environment, emphasize the importance of high-quality and forward-looking disclosure by companies, and convey that good faith attempts to provide investors and other market participants with appropriately framed forward-looking estimates should not be second-guessed. The OECD should consider the complex interrelationships between financial reporting, auditors, and the fragility of our capital markets, and should suggest short-term policies to reduce the possibility of failure.

AGM

Due to the Covid-19 crisis, some countries have allowed listed companies to extend the deadline to convene their annual shareholder meeting. However, this should not lead to physical meetings being held in too short a period of time with little notice, or not being held at all. Under normal circumstances, an AGM may be validly convened with a minimum notice period. Business cannot be transacted at an AGM unless a quorum is present. However, the COVID-19 pandemic poses a challenge as the written resolution procedure may be unavailable, and a director and other shareholders may be prohibited from voting. Companies will need to make provisions for voting where directors cannot be physically present at a shareholder meeting and where the constitution or articles do not allow for electronic voting.

While virtual AGMs are being considered, shareholders should still have the right to propose motions and to ask questions. We suggest the OECD seek to understand what lessons can be learned from the new "virtual" AGMs: Were companies prepared and what technological tools were most effective in running the meeting?

Duties of the Board/directors

Even in a crisis, the duties and obligations of directors in carrying out their roles do not change. Directors' duties differ around the world but, in general, include duties of care and loyalty to the company as a whole, whilst considering the implications of decisions on employees, suppliers and other stakeholders. It is important that directors consider the impact on the company's reputation and long-term prospects. In order for directors to meet the ongoing challenges, effective communication is essential. At a later date, the board may well have to prove due consideration of decisions made today. The OECD could help gather information on how countries and companies, listed and unlisted, address emerging issues about the role of the board in a crisis.

Restructuring and ESG Issues

Restructuring a business may involve redundancies, requirements to take holiday leaves, asset sales, reduction of investment, negotiations with landlords, creditors, suppliers and other such initiatives. If for example, a company accepts new sources of credit, in the hope that this will keep its people employed, this may create legal and financial problems for individual directors in the longer-term. The OECD could help track how policies at the company level and consideration of stakeholders in company decision-making operate in times of stress.

M&A

Mergers or acquisitions are already being affected by COVID-19. There are challenges in both discovery of financial and operating information, and in undertaking robust due diligence. Site visits may not be possible, 'hands on' review of inventory or confirmation of valuation of assets also may not be possible. Negotiations may be difficult by phone or electronic conferences. Yet, much can be accomplished through the internet, such as review of compliance manuals and digitized documents. Documenting challenges and possible solutions in this context might prove helpful.

Takeover rules

In some countries, the policy response to the COVID-19 crisis has also affected the takeover rules by national regulators. In a number of OECD countries, we see additional government discretion what counts as a 'strategic company' in the approval process. Questions to be considered include how this approach might impact financial markets and the presence of foreign investors and enable more government involvement. In this light, it would be interesting to explore other temporary solutions that would enhance companies' role such as, for example, lightening company law burdens with regard to defense measures.

Special consideration for SMEs

SMEs deserve particular attention, as smaller businesses are likely to be heavily impacted by the crisis. Beyond the policy provisions aimed at facilitating SMEs' access to immediate financing, we believe that some additional and temporary measures could suit their needs such as facilitated access to market financing (e.g. through fiscal incentives, enhanced scaling of transparency and governance measures).