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Confédération Européenne des Associations d'Administrateurs
European Confederation of Directors' Associations

Review of the OECD Principles of Corporate Governance

ecoDa's perspective

January 2015,

As already expressed in a previous paper (29 October 2014) ecoDa is a strong supporter of the OECD Principles of Corporate Governance. We recognise the influential role that they play in both developed economies and in less developed countries that are in the process of designing a modern policy framework of corporate governance.

ecoDa is largely in agreement with the amendments proposed in the new draft of the OECD Principles. The changes have updated and improved the text in the light of current governance challenges, and we congratulate the OECD for such a considered proposal. In this document, we provide our perspective on some of the key issues.

- **The Comply or explain principle (p.3):**

ecoDa welcomes the amendment that suggests that governments and regulators should take initiatives to better inform "companies and their stakeholders about the benefits of implementing sound CG practices". Research into what constitutes valid explanations and alternative governance processes might also be useful in improving public understanding of good governance. Annual awards as organized in the UK (by Hermes/ICSA) to reward companies with the best explanations could be repeated in other countries.

Such developments would foster what has been referred to as a 'best practice' approach. According to this philosophy, corporate governance structures and procedures should be compliant with the basic principles of good governance while leaving the individual company with the responsibility of demonstrating to the outside world that its practical implementation and fine tuning fits the company's strategy, ambitions, specific circumstances and challenges.

- **The functioning of Stock Markets (p.4)**

ecoDa welcomes the recognition that "the functioning of stock markets plays a pivotal role for the quality of corporate governance". It is our perception that regulators often do not pay much attention to the business models of stock exchanges - there is a risk that the resulting marketplace for stocks does not encourage long term share ownership but facilitates excessive trading and short-term speculation.

- **Cross-border cooperation (p.6):**

Cross-border cooperation is important not only for regulators but also for the other actors in corporate governance. ecoDa plays an important role in this sense by promoting best corporate governance practices in Europe. The Global Network of Director Institutes (GNDI), to which ecoDa contributes, also plays an emerging informational and competence-building role amongst national institutes of directors outside the EU.

In our view, the OECD could highlight to policy makers and regulators the importance of promoting the creation of national institutes of directors in countries where there is currently no such organization. Indeed, director institutes are increasingly seen as an important facilitator of professional boards of directors, an important factor in institutional competence building and as such a respected actor of civil society.

- **Say on Pay (p.9)**

Shareholders have an obvious role to play in approving the remuneration of the board of directors. However, the role that shareholders should play in determining the remuneration of executives and senior managers (both those sitting on the main board and those involved on executive committees) is much less clear-cut. Management pay policy would appear to be a more logical responsibility for the board rather than shareholders. After all, if the shareholders are to make all of the key decisions concerning management, there is very little point in having a board in the first place.

It is therefore a challenge to find a wording in the Principles that, on the one hand, fosters a greater sense of corporate accountability over pay policy – which has rightly been a source of political controversy for policy makers and the general public in many countries - without on the other hand transposing the role of the board onto the shareholders' meeting.

The approach taken by the OECD in stating that "shareholders should be able to make their views known, including through votes at annual shareholder meetings, on the remuneration of board members and key executives" seems to ecoDa to strike a reasonable balance on this issue.

- **One share, one vote (p.11)**

ecoDa believes that, in the future, policy makers will need to examine new ways of encouraging long term share-ownership. Consequently, we welcome the deletion of the text on page 11 concerning "one-share-one-vote". We agree that the OECD Principles should take a neutral stance on this issue.

- **Related-party transactions (p.12-13)**

Any transaction between a company and its shareholders, directors or managers, should take into account the interests of all of the shareholders (not just connected parties). Companies should therefore safeguard the interests of minority shareholders in these types of transactions if they wish to stay attractive for 'outsider' shareholders and be sustainable companies in the long term.

In countries with significant amounts of controlling shareholders, independent directors have a special role to play in RTPs - which is well-emphasized in the revised OECD Principles. Indeed, we believe that independent directors should be trained to better understand this important role.

- **Proxy advisors (p.17)**

Proxy advisors can play a useful role in optimizing the monitoring role of investors. But a number of additional challenges have to be met. They need to be aware of the need for clear guarantees in relation to potential conflicts of interest. Also more transparency is needed as to the methodology used. Moreover their global presence needs to be combined with a tailored approach in view of national governance environments as well as corporate specificities, rather than using a "one-size-fits-all" approach (based on the dominant corporate logic of the US market, which is often irrelevant for many continental European companies). To this end, a more intense dialogue with the listed companies -prior to making their proxy voting proposals public- might be in the interest of both the companies and the proxy advisors themselves. If proxy advisors want to be(come) a well-appreciated partner in the struggle for good governance, they should be more accountable with respect to the quality of their methodology as well as their specific recommendations. An important step has been made in this direction with the Best Practice Principles of the Proxy Voting Industry. The OECD should stimulate Proxy Advisory Service Organisations to comply with these Best Practices Principles.

- **Non-financial reporting (p.27)**

Although ecoDa is supportive of enhanced non-financial reporting, it has addressed in the past some challenges:

- There is no European standard reference framework for disclosing such non-financial information: for non-financial reporting, there is no equivalent to the IFRS framework for disclosing financial information. In general, it is difficult to identify relevant qualitative non-financial indicators or find generally accepted definitions and measuring techniques.
- The relevant reference data for non-financial reporting are necessarily quite different from one company to another, from one sector to another, from one country to another.

ecoDa would recommend to clarify clearly specify what it is meant by non-financial reporting in order to avoid the confusion with CSR.

- **Employee participation & Gender diversity (p.26 and p.36)**

In certain EU Member States (like France), employee share ownership has proven to be a viable route for aligning the interests of the corporation and the employees, while at the same time promoting the long term sustainability of corporations.

Moreover the public outcry over the excessive variable remuneration of top executives in some countries could be transformed into a more positive perception if corporations would enlarge the concept of variable remuneration to a more inclusive approach involving a wider range of employees, including granting shares or share options.

However attempts to introduce such systems in other countries (e.g. in Belgium) have been without great success. There are serious impediments. First and foremost, employees fear the downside such investments might entail, especially if these investments represent the only non-diversified investment employees possess.

On the other hand, non-diversified investments can make employees care about their company and this can generate a new dynamic in the company as far as employees are concerned. Additional points of challenge include the ‘classical fight between capital and labour’ mentality in some contexts, which would be incompatible with significant employee ownership.

There are concerns about the pressure that employees can exercise on the appointment of board members in shareholders’ meetings. Board composition should be tailored to the specific circumstances of the company, its challenges, strategic ambitions and time demands. Therefore it is doubtful that general recipes can be developed. Case by case tailoring should be the rule. ecoDa welcomes therefore the wise approach taken by the OECD in its proposed text.

- **Aggressive tax avoidance (p.30)**

At the bottom of page 30, the new text about aggressive tax avoidance seems somewhat out of place – but that is a relatively minor point (even if providing more transparent information on this item goes into the right direction).

- **Investment relations officer (p.34)**

On page 34, paragraph 118 states that “in some jurisdictions, the appointment of an investment relations officer who reports directly to the board is considered good practice for large listed companies”. ecoDa is not familiar with such an appointment – in our experience, investor relations teams report to the CFO or CEO, i.e. they are an executive function, not a board function. ecoDa therefore suggests to clarify the suggestion to ‘directly report to the board’ in the sense that the IR officer regularly reports to the board (as other managers do). However for sake of clear lines of leadership and management accountability it should be clarified that there is no need for a direct reporting in the sense of a direct accountability line towards the board.

- **Audit committee (p.35)**

The OECD CG principles should take better consideration of the different corporate governance models existing in Europe with respect to audit committees. For example, the Nordic CG model does not fit well with the idea of a board committee being responsible for overseeing relationships with the external auditor. In Nordic eyes, this task should typically be the rightful responsibility of a committee of the General Meeting, not the board (typically the nomination committee in Nordic companies).

- **Boards’ evaluations (p.36)**

ecoDa considers board evaluations to be an increasing important component of the functioning of a professional board. This is still an emerging area – as yet, there is no universal agreement about how board evaluations should be conducted. Nonetheless, we see board evaluation – along with more widespread director training – as a key non-regulatory means by which the functioning of corporate governance can be enhanced in the future.

In conclusion, ecoDa wishes the OECD every success with the latest edition of its Principles of Corporate Governance.

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About ecoDa:

The European Confederation of Directors' Associations (ecoDa) is a not-for-profit association founded in December 2004 under the laws of Belgium. Its objective is to represent the views of company directors from EU member states to corporate governance policy-makers at EU level.
ecoDa, the European Confederation of Directors' Associations, is a not-for-profit association acting as the "European voice of board directors".
Through its 16 national institutes of directors, ecoDa represents around sixty-five thousand board members from across the EU, ensuring that their views on Corporate Governance are clearly communicated to policymakers in the EU institutions. ecoDa's member organisations represent board directors from the largest public companies to the smallest private firms, both listed and unlisted.

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ecoDa full members:

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- The British "Institute of Directors" (IoD)
- The Belgian GUBERNA
- The French IFA
- The Luxembourg ILA
- The Directors' Institute of Finland
- The Spanish institute "Instituto de Consejeros – Administradores"
- The Slovenian Directors' Association
- The Polish Institute of Directors
- The Norwegian Institute of Directors
- The Swedish StyrelseAkademien
- Vereinigung der Aufsichtsrate in Deutschland e.V., VARD
- The Dutch "Nederlandse vereniging van Commissarissen en Directeuren"

- The Italian Directors’ Association, Nedcommunity
- The Croatian Institute of Directors

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- The Macedonian Institute of Directors, MIoD

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- The Danish Board Network