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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

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.

In this document, we provide our perspective on some of the key issues identified by the OECD discussion paper: Expert Consultation on the Review of the OECD Principles of Corporate Governance, published on 17 March 2014.

In this submission, we wish to particularly emphasize the central role played by the board of directors in corporate governance. An independently-minded board is uniquely well-placed to oversee the best interests of the organisation. Unlike most external stakeholders (including shareholders), it has unrestricted access to the company's management, information and resources. Furthermore, an effective and well-balanced board contains individuals with a significant amount of relevant experience, expertise and business acumen.

What concerns ecoDa is that "good governance" is increasingly being defined in terms of shifting key decision-making powers from the board to shareholders or other stakeholders (e.g. in respect of the "say on pay" or related party transactions). We perceive that this approach may be underpinned by an implicit mistrust of boards by policy makers and wider society.

ecoDa recognises that the reputation of boards has taken a battering as a result of the financial crisis and other corporate failures. However, rather than shift powers away from boards towards less well-positioned governance actors, ecoDa believes that the perception problem of boards should be addressed head-on. The effectiveness and objectivity of boards should be developed by things such as improved training and professional development of directors, encouragement of greater boardroom diversity, and use of board evaluation techniques. Most importantly, a key means of rebuilding trust in boards will be the development of a more transparent and professional approach to the appointment of directors.

Although ecoDa is fully supportive of encouraging shareholders and other stakeholders to take a more active role in the stewardship of corporations, it should not be forgotten that boards of directors are the central actors in any system of corporate governance. Ultimately, the key to a more effective governance system will be the emergence of more competent and legitimate boards. This is an objective to which ecoDa is fully committed. However, is also an objective that should be more strongly emphasized in the OECD Principles.

Chapter I: Ensuring the basis for an effective corporate governance framework

Question 1: In order to reflect the mandate of the Corporate Governance Committee and increase the clarity about the objectives that have guided the formulation of the Principles, would it be useful to make a better distinction in the opening chapter between policy objectives (growth, efficiency and stability) and the means by which these objectives are achieved, notably transparency, market integrity and sound incentive structures? Such a clarification may not only be useful to readers who want to understand the nature of the Principles but also when interpreting subsequent recommendations, for example with respect to impact assessment.

We agree with this proposal. In our experience, corporate governance can be perceived by many stakeholders (particularly practising directors) as a bureaucratic compliance activity. It may also be perceived as an obstacle to entrepreneurial development. It is important to provide justification for corporate governance principles in terms of their positive impact on performance, economic growth and the perceived social legitimacy of the business sector.

Question 2: Considering the merits of allowing an "orderly" flexibility within a given regulatory framework would it be useful if the Principles provided some basic guidance on what principles should be followed when building an enabling legal and regulatory framework? What are the possible pitfalls and what are the safeguards that should be put in place? Would it be useful to provide examples of workable "opt-out" provisions and discuss the principles for shareholder approval and/or regulatory recognition of corporate level deviations from default regulation?

We agree. In any governance policy framework, there is a balance to be had between regulation, codes, best practice and other policy initiatives (e.g. education programmes). However, in our discussions with policy makers, ecoDa often perceives that 'hard law' is seen as the main policy mechanism.

For example, the unlisted/unquoted corporate sector is an area of the economy which would not necessarily benefit from the introduction of a significant amount of prescriptive corporate governance regulation. ecoDa's Corporate Governance Principles and Guidance for Unlisted Companies seeks to promote better governance in this area by means of a voluntary guide in which governance principles are applied on the basis of a dynamic stepwise process which takes account of the specific nature of a company in terms of size, complexity, and maturity. Ideally, the OECD Principles themselves should now reflect the variety of processes through which its recommendations could be implemented by policy makers and market participants.

A route for improving governance effectiveness is by making better use of the principle of 'comply-or-explain', a principle fully backed and supported by ecoDa (See Report of ecoDa's 2012 annual conference on "Comply or Explain: preserving governance flexibility with quality explanations"). We plead for a more effective framework of regulation and self-regulation work by promoting better implementation and higher quality explanations. To this end, it would be good to further optimize the national expertise gained and develop guidance.

Question 3: Would it be useful to elevate the importance of regulatory impact assessment to a self-standing principle in Chapter I? Should such a principle be coupled to the issue of sufficient resources in the regulatory process?

Yes. However, we would also point to the poor quality of many impact assessments that are undertaken by regulatory authorities. They are not a silver bullet, although they should be seen a valid part of the policy development process.

Similarly, ex-post impact assessment of the efficiency of newly implemented regulations should be regularly undertaken within an appropriate time frame after their enforcement.

Question 4: Can the Principles provide any general advice or principles on how to approach the issue of "scaling" of regulatory requirements? If not, are there any good specific examples of "scaling" that could be included and be helpful to the reader of the Principles?

We strongly agree. ecoDa's perspective on governance regulation is that it should always be tailored to the size, complexity and maturity of business enterprises. We are opposed to a 'one-size fits all' approach. For example, a small private company would not be advised to attempt compliance with a national corporate governance code that has been primarily designed for large listed companies with dispersed ownership. Such an approach would be disproportionate and add little value to the enterprise.

Consequently, the OECD Principles should highlight the fact that they can be used as the starting point for a wide range of possible governance policy initiatives in addition to the flagship national code of governance for listed equity. However, its application in each specific instance needs to be tailored in a proportionate and 'scaled' manner.

Question 5: Do participants consider that Chapter I should address the issue of dual mandates, where regulators may be in charge of both regulation and promotion of the financial market in a particular jurisdiction?

Chapter 1 of the OECD Principles already states that "The division of responsibilities among different authorities in a jurisdiction should be clearly articulated and ensure that the public interest is served." However, we can see the value of making this potential conflict of interest more explicit by an adjustment to the wording of this chapter.

Question 6: In order to increase clarity, and in line with the current principles I.C and I.D, would it be useful to formulate some basic principles that could guide

the division of responsibilities between stock exchanges and public authorities with respect to standard setting, supervision and enforcement with respect to corporate governance related listing requirements?

Yes. Some guidance on how to guide the division of responsibilities between stock exchanges and public authorities could be developed in the annotation to the OECD Principals.

Question 7: Considering the important number of cross-listed companies worldwide and changes in the stock exchange industry, would it be useful to address the standards and procedures that apply for recognition of primary listing corporate governance standards in the case of secondary listings? Should such a principle or annotations include an international co-operation aspect?

As yet, we do not see this as a major issue for inclusion in the OECD Principles.

Chapter II: The rights of shareholders and key ownership functions

Question 8: How can Chapter II address the lack of economic incentives among institutional investors to carry the costs that are associated with informed ownership engagement? When it is not in the economic interest of an institution, is there any way that public policy can influence the economic incentives of the institution to vote without interfering with the very business model of the institution? What would be the rationale for such policies? In order to avoid the risk of a cost-minimizing box-ticking culture of one-size-fits-all, should the Principles explicitly discourage policy-makers from mandating institutions to vote their shares?

One approach would be for the OECD to develop a global version of the UK Stewardship Code as a means of encouraging equivalent initiatives in individual countries. However, we do not think that it should be a policy aim for investment institutions to be forced to adopt a particular kind of investment policy.

In our view, the OECD Principles should take a neutral perspective on the issue of obligatory voting by investment institutions. An explicit recommendation in the Principles on this issue would be too prescriptive and not necessarily relevant in all policy contexts.

We also wish to stress that the OECD Principles should not focus its entire attention on promoting the interests of institutional investors or minority shareholders. It should recognise to a much greater extent than currently that blockholders/large shareholders play a significant ownership role in companies around the world, and may also play a positive role in corporate governance. This chapter should reflect the diversity of ownership structures.

It is not realistic to turn inactive shareholders into micro-managers. Since Berle and Means, it has been observed that in larger companies, dispersed shareholders are often unable to properly monitor companies, leading to the creation of an interface: the board of directors. If the board is not performing its duties the shareholders should dismiss the board, not take over the management of the company. ecoDa therefore

proposes to further reflect on ways to really make boards accountable to shareholders, rather than to make them decide on the nitty-gritty details of all types of decisions.

Question 9: Since institutional investors regularly outsource the management of the shares they own to asset managers, would it be useful if the Principles clarified whether the corporate governance related fiduciary duties (like the ones mentioned above) remain with the asset owner or should equally be carried by the asset manager?

First and foremost, we would like to encourage a strong sense of fiduciary obligation – and a commitment to ownership and stewardship – amongst asset owners. In heavily disintermediated financial systems (e.g. the US or the UK), asset managers are ultimately only the hired agents of asset owners. Their behavioural incentives are largely driven by the contractual demands and performance orientation of asset owners. By promoting the fiduciary role of asset owners, the OECD Principles should seek to establish good stewardship principles at the beginning of the investment chain, and then promote its transmission along the chain.

Question 10: Considering the increased reliance on proxy advisory services by institutional investors to vote their shares and the use of other service providers, how can the Principles address the possible unintended consequences and conflicts of interest that outsourcing of ownership responsibilities to service providers may cause?

We see proxy advisors as a necessary component of a financial system with highly dispersed ownership and a significant role for institutional investors. Although it would be desirable for asset owners and fund managers to engage more directly in governance issues, there are obstacles to this objective given the current market structure and incentives of the investment management industry.

In that context, informed and beneficiary-aligned proxy advisers can play a valid role in securing a meaningful voice for shareholders. It would be useful, however, for the OECD Principles to highlight issues relating to transparency, methodology and conflicts of interest of the proxy advisory industry which may need to be addressed by policy in national jurisdictions.

Question 11: Should Chapter II make explicit recommendations with regard to say-on-pay? If so, what should be the guiding principles in terms of coverage? For example, should the vote encompass both the structure and the level of remuneration? Should it cover both executive officers and board members? Should it include other corporate officials? In the case of performance related remuneration, should ex-post adjustments in the form of malus and claw-back provisions be encouraged?

We would broadly agree with the above proposal, although we would recommend that the OECD Principles remain at a relatively high level of generality and do not promote specific forms of policy implementation which may not make sense in all national contexts.

For example, a 'say on pay' is implemented in many jurisdictions through legislation rather than the national corporate governance code. Also there are significant variations in its form (e.g. binding or advisory, relating to pay policy or pay outcomes, etc). We would not advocate that the OECD Principles is too prescriptive about this.

The board is the body where the company's interest is considered while at the GM the opinion and individual interests of shareholders can prevail. ecoDa would like to stress that it is important that boards keep the leadership in defining the level and the structure of executives' remuneration while the remuneration of non-executives has to be decided by the shareholders.

Chapter III: The equitable treatment of shareholders

Question 12: Should the Principles with respect to related party transactions be more explicit about the need for supervisors, enforcement authorities and perhaps shareholders to gain access to information about the beneficial owners of entities that engage in transactions with the company?

We see independent or outside directors as being the main safeguard against related party transactions. However, for major transactions requiring a shareholder vote, we would agree that external stakeholders need access to this kind of information.

This question should be put in perspective with the fact that there is a lack of a group governance approach throughout Europe and at international level.

Question 13: Taking the type and significance of a transaction into account, what is the best mix of the regulatory strategies, such as mandatory disclosure, (disinterested) board approval, (disinterested) shareholders' approval, as well as the assessment by an outside specialist? What measures should be encouraged to ensure the effective means of redress by minority shareholders (e.g. establishing specialised courts, offset legal fees for derivative actions)? Which additional measures can be recommended to prevent abusive related party transactions?

As stated above, we believe that trusted and respected independent directors – with genuine credibility as independent actors on the board – should be the mainstay of minorities' protection against related party transactions.

There is significant debate about whether, for transactions of significant size, it is appropriate that independent minority shareholders should exercise a strong voice in their approval. However, this raises the question of business efficiency. Such an approval process creates the necessity for either a costly additional extra-ordinary meeting, or the need for postponing the transaction until after the next annual general assembly. Moreover this proposal neglects the potential abuse of minority positions by giving (small) minorities a veto right in business decisions. An a-posteriori ratification may provide an efficient safeguard, if the transaction is considered by the shareholders to be harmful for the company, triggering the board's liability.

Question 14: Considering the large (and growing) number of corporations with controlling and dominant shareholders worldwide, would it be useful to develop a special section that addresses the corporate governance issues that announce themselves in such ownership structures, such as related party transactions,

disclosure of beneficial ownership and company groups? What principles can be applied in order for the regulatory framework to provide incentives for engaged and value creating ownership engagement by controlling owners? What provisions must be in place to protect minority shareholders from potential abuse by controlling owners?

This is a significant issue that is not really addressed in the current edition of the OECD Principles. It is also relatively undeveloped in national codes of governance. However, relevant regulation for companies with controlling shareholders is emerging in the listing rules of various jurisdictions, such as the Enhanced Listing Regime in the UK (which came into effect in May 2014) and the Listing Regime in Hong Kong.

The key element of these new rules is to give independent shareholders (i.e. excluding the controlling shareholder) the opportunity to vote separately on key issues, such as related party transactions and the appointment of independent directors. The UK rules also mandate the implantation of a legally-binding relationship agreement between the company and the controlling shareholder as a means of ensuring that controlling shareholders remain at arms length from the company.

However, ecoDa is also eager to stress that controlling shareholders can bring positive benefits to a corporation as well as potential abuse of minority shareholders. They can promote a more long-term approach with a focus on R&D, investment and human capital development. It is hence important that the OECD Principles are not seen as only supporting the perspective of minority shareholders or a dispersed pattern of ownership. The Principles should be agnostic between differing ownership structures – concentrated or dispersed. Either should be seen as viable within an appropriate institutional context which introduces checks and balances in relation to potentially undesirable behaviour.

Question 15: Would a recommendation to restrict brokers/custodian from voting without explicit instruction, particularly on key corporate issues, be an effective way of promoting ownership engagement? Regarding the voting practices at shareholder meetings, which additional measures can be recommended to increase the quality of ownership engagement?

We do not believe that such agents should vote the shares. The exercise of their voice in governance issues is not really legitimate and may be subject to a variety of conflicting interests which do not necessarily reflect those of the ultimate beneficiary. In such cases, they should abstain from voting.

Chapter IV: The role of stakeholders in corporate governance

Question 16: Could Chapter IV be complemented with guidance on corporate governance policies that may facilitate corporate access to capital by the use of corporate bonds and improve the functioning of corporate bond markets?

We agree. We see long-term bondholders as having interests that are often strongly aligned with the long-term success of the company. Consequently, in addition to shareholders, we think it would be useful if the Principles recognised the contribution made by other providers of capital to modern companies. It could encourage the board's interest in listening to the views of such providers as part of a company's overall approach to governance.

Question 17: Do new organisational structures and contractual forms between the company and its employees give raise to incentives that, at an economy wide level, should affect the governance structure of corporations and call for wider participation in the governance process? Are there any obstacles to develop performance enhancing employee participation, for example employee board representation or participation in certain key decisions?

Overall we agree that the company should engage with a wide range of stakeholders as part of its governance framework. However, the precise manner in which this is undertaken will depend on a variety of factors, including local historical, political and cultural circumstances. In some jurisdictions – such as Germany and the Nordic countries – employee involvement on boards of directors is already a well-established fact. However, in other socio-political contexts, it may not be always be feasible to prescribe employee representatives on the board of directors. In the OECD Principles, we would favour more high level encouragement of broad stakeholder involvement. However, we would guard against being too prescriptive or advocating a specific model of stakeholder participation.

Chapter V: Disclosure and transparency

Question 18: Does the de facto global convergence of accounting standards call for a new approach to how the Principles address disclosure? Should Chapter V and related annotation primarily provide guidance on how to complement financial reporting disclosure with corporate governance disclosure requirements?

We do not see this as a major issue for the OECD Principles. There are a variety of international frameworks addressing disclosure issues, such as those relating integrated and narrative reporting. We would not see the Principles developing as a competitor to these frameworks.

Question 19: In which areas would additional disclosure requirements be particularly useful? Are there areas where existing disclosure requirements have not proven particularly useful in terms of improving transparency? Should the principles or the annotations provide any guidance on how disclosure can be more, succinct, informative and accessible?

The Principles could point the way to the other guidance on transparency and reporting, such as the GRI initiative.

Question 20: With a view to restore confidence in public equity markets, ensure equitable treatment of shareholders and improve capital allocation, should Chapter V include a principle on investor access to market information, including stock prices?

In our view, good corporate governance is about long-term relationships between companies and their stakeholders. Short-term fluctuations of share prices – and the access of investors to such information – is much less relevant to good governance. Consequently, we see this point as being more about the effective operation of stockmarkets than corporate governance.

Chapter VI: The responsibilities of the board

Question 21: What additional guidance can the principles provide that would improve board responsibilities in the context of company groups and with respect to risk management? Would such changes primarily focus on the board structure or procedures, including access to corporate risk-officers?

We are concerned that the legal responsibilities of directors of subsidiary companies are often not aligned with their operational responsibilities as executives of a wider business group. It is a commonplace occurrence for these interests to conflict. It would be valuable for the OECD Principles to offer guidance on how to address these issues.

Question 22: Should Chapter VI express a clear preference for separating the roles of CEO and Chair?

Our general approach is to avoid excessive prescription with regard to governance recommendations, particularly in a high level statement of principles. However, we see the split between Chairman and CEO as being fundamental to modern corporate governance. Except in exceptional circumstances, we would see such a split as being either necessary or desirable in most corporate governance systems. We would hence support explicit highlighting this split in the OECD Principles.

Others comments:

ecoDa is convinced that strict regulation will not be the ultimate solution to outstanding governance issues. On the contrary, more effective board monitoring from within the company will need to be further stimulated and developed. It would be good if the politicians and decision-makers would support and even promote initiatives that aim at promoting the professional development of directors and developing the boards' capacity of collective decision making. ecoDa and its member organisations have built substantial expertise in developing education programmes for directors (some of them also certifying directors that successfully pass a set of professional education programmes) and mentoring programmes for candidate directors while also supporting the development of induction programs (to build sufficient governance insights for directors).

Given the important role director institutes can play in promoting director education, ecoDa is looking for support in the development of new director institutes in European member states where such organisations have yet to be established.

Another important instrument to promote good governance practices is to put more emphasis on appropriate governance behaviour and boardroom dynamics by stimulating more objective and robust board effectiveness reviews and individual director assessments.

One important ingredient of boardroom legitimacy and objectivity is director independence. Formal governance criteria situated in governance codes provide a first stimulus to 'a-priori' define board independence, but such approach should be complemented with additional monitoring instruments and guarantees for effective board independence. To this end one could look at both the minimum norms for board independence (number or % of independent directors on boards and board

committees), and mechanisms for monitoring 'ex-post' the behaviour of independent directors (e.g. to be included in board and director assessments).

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Contact:

Béatrice Richez-Baum, Secretary General, contact@ecoda.org

Lutgart Van den Berghe, Chairwoman of ecoDa's Policy Committee
Lutgart.VandenBerghe@guberna.be

Roger Barker, Director of Corporate Governance, Institute of Directors
Roger.Barker@iod.com

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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- The Danish Board Network