



6th SOUTH EAST EUROPE CORPORATE GOVERNANCE ROUNDTABLE

17 February 2006

Enforcement of Corporate Governance Rules

Meeting Co-Hosted by
The Federation of Euro-Asian Stock Exchanges



With the Support of

The Government of Japan

**The Global Corporate
Governance Forum**



Synthesis Note

6th Meeting of the South East Europe Corporate Governance Roundtable

Istanbul, Turkey, 16 and 17 February 2006

Synthesis Note

On 16 and 17 February 2006, the sixth meeting of the South East Europe Corporate Governance Roundtable took place in Istanbul, Turkey.

The South East Europe Roundtable's discussions focused on: (i) recent developments and future reforms aimed at the implementation and enforcement of the recommendations of the White Paper launched by the Roundtable in 2003 in the region; ii) the responsibilities of securities regulators in the enforcement of corporate governance rules; iii) the private sector's role in corporate governance enforcement. On the first day the recently adopted OECD Guidelines on Corporate Governance of State-Owned Enterprises were considered for the first time by the Roundtable, and the role of banks in corporate governance was addressed.

As an immediate follow-up, the OECD Secretariat will work with the participants of the SEE Roundtable to develop a report to the Ministerial Meeting of the Investment Compact, scheduled in July 2006, on the main conclusions of this Roundtable meeting and an action plan as to the future priorities of the SEE Roundtable. In addition, it was agreed that the Secretariat should pursue possibilities for a broader involvement of companies in the work of the Roundtable. A priority hereby should be the creation of a group of companies from the region which could serve as models for successful changes to the governance structure for other companies throughout the region (so-called "Companies Circle"). Moreover, it was suggested that the Roundtable should have a mechanism for measuring progress in the implementation of the White Paper recommendations on a regional basis, which could also serve as an input at political level (for example, through the Investment Compact), options which should be investigated further. The Roundtable also welcomed Bulgaria's offer to host the next Roundtable meeting.

The first day of the meeting was held jointly with the Eurasia Corporate Governance Roundtable. The meeting was co-hosted by the Euro-Asian Federation of Stock Exchanges (FEAS) and supported by the Global Corporate Governance Forum, the Corporate Governance Association of Turkey, the Government of Japan, the Istanbul Chamber of Commerce, and the United Nations Development Program. It was organised by the OECD in co-operation with the World Bank Group.

In the meeting, some 60 experts and policy-makers from the region (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Former Yugoslav Republic of Macedonia, Romania, Serbia and Montenegro), OECD countries (Germany, Greece, Norway, Poland, Switzerland, Turkey, UK and US) and international organisations (Center for International Private Enterprise, European Bank for Reconstruction and Development, Global Corporate Governance Forum, International Finance Corporation, OECD Secretariat, United Nations Development Program, United States Agency for International Development, and World Bank) were present. For the joint meeting with the Eurasia Roundtable, some 120 participants were present, including members of FEAS from the MENA region.

The meeting was opened by **Mr Osman Birsen**, President, Federation of Euro-Asian Stock Exchanges; **Mr Korkmaz Ilkorur**, Chairman of the Corporate Governance Working Group of the Turkish Industrialists' and Businessmen's Association; and **Mr Rainer Geiger**, Deputy Director of the Directorate for Financial and Enterprise Affairs of the OECD. The speakers stressed the importance of the work of the South East Europe and Eurasia Roundtables in the corporate governance reform process in the respective regions, but also pointed out some of the main challenges still lying ahead. Reference was also made to the importance attributed by Turkish institutions to efforts in the area of corporate governance in Turkey and to the good co-operation between the OECD and FEAS.

First Day – 16 February 2006

Session 1 – Why is Good Corporate Governance of State-Owned Enterprises Important?

In the first session, chaired by **Mr Rainer Geiger**, the OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOEs), which were adopted by the OECD Council in April 2005, were presented by **Ms Mathilde Mesnard** of the OECD. The Guidelines are non-binding and represent best practices on the corporate governance of SOEs, and are complimentary to the OECD Principles of Corporate Governance, on which they are based and with which they are fully compatible. The presentation provided an overview of the rationale for the OECD's developing the Guidelines, namely the scale and scope of the state sector, the impact of SOEs on economic performance, the pressure for reform deriving from globalisation and liberalisation, specific governance challenges, expected benefits from improvements of SOE governance, and finally, the strong demand from non-OECD economies. The priorities of the Guidelines are: to provide for a level playing field with the private sector, to reinforce the ownership function within the state administration, to improve transparency of SOEs' objectives and performance, to strengthen and empower SOE boards, and to provide equitable treatment of minority shareholders. It was also mentioned that the OECD would publish a comparative report on SOEs.

In the following floor discussion, it was clarified that non-OECD countries also had the opportunity to give input to the SOE Guidelines and that meetings like these Roundtables provided an opportunity for the OECD to gather additional input for any future amendments to the Guidelines. As regards the scope of the Guidelines, Ms Mesnard reminded participants that they were primarily oriented to SOEs using a distinct legal form (ie separate from the public administration) and having a commercial activity (ie with the bulk of their income coming from sales and fees), whether or not they pursued a public policy objective. Views were expressed that some governments in participating countries considered improvements to the governance of SOEs not as a precondition for successful privatisation, but rather as an alternative to privatisation.

Session 2 – The State as Shareholder:

Chaired by **Mr Daniel Blume**, Principal Administrator in the OECD, this session addressed the role of the state in the governance of SOEs within the two regions, which was also compared with experience in other transition and emerging markets. In his presentation, **Mr Cyril Lin**, Managing Director of IFG Development Initiatives Ltd. from the UK, provided a comparative outline of corporate governance of SOEs in Central Asia, where the role of the state in the economy was still dominant. He mentioned some of the main problems regarding SOEs in that region, such as insufficient legal framework, risk bearing not reflecting controlling ownership by state, widespread discrimination against non-state minority shareholders, and strong correlation between shortcomings in overall public governance and governance of SOEs.

Ms Olha Trypolska, Deputy Director of the Ukrainian Association of Investment Business, referred to the Ukrainian government's project to create a code of corporate governance for SOEs, which had not yet materialised, and to the already noticeable improvements in the practices of the state in the exercise of its ownership role. **Mrs Petra Alexandru**, Executive Director of the Bucharest Stock Exchange, explained the situation in Romania regarding governance of SOEs, where privatisation, in particular of large utility companies, was in progress, some 20 SOEs were listed on the exchange and the government had adopted two decrees on corporate governance. **Mr Pawel Calski** of the Polish Ministry of Finance outlined the situation in Poland where SOEs still represented a large part of the economy and mentioned the World Bank Group's review of its reform process, which will soon be published, and could provide useful guidance to other transition economies, too.

In the subsequent discussion, the point was made that the reform of overall public governance, which was necessary for improving corporate governance of SOEs, would be a very long process. Bearing in mind the dominant role of SOEs in most participating countries, other approaches, which would could yield quicker results, would have to be explored. Regarding the role of regulators in protecting non-state shareholders in SOEs from abusive practices, it was stressed that the state bodies exercising the ownership role in SOEs had primary responsibility for avoiding any such practices in the first place.

Session 3 – Boards of State-Owned Enterprises:

Empowering and improving the quality of boards of SOEs is of fundamental importance for improving the corporate governance of SOEs. In Session 3, chaired by **Mr Chris Pierce**, CEO of Global Governance Services Ltd. from the UK, the different approaches in this area were considered. **Mr Thomas S. Geiran** of the Norwegian Ministry of Trade and Industry provided a brief overview of the approach taken by the Norwegian government in the SOE governance, such as the adoption of ten ownership principles. He referred to legal provisions preventing government officials from being on the boards of SOEs, as well as the use of external nomination committees in the board nomination process and the appraisal of the performance of incumbent board members. Finally, he informed participants that special attention was paid to allow for boards to play their important strategic role and that at least half of the board of an SOE had to be independent. The approach taken by Norway could be contrasted with more interventionist approaches by countries in the two regions, where the state even had a say in

the day-to-day business of SOEs. Questions from the floor concerned the practicalities of the role of the Norwegian state in assuming its ownership role.

Mr Plamen Tchipev, Senior Researcher at the Bulgarian Academy of Sciences, illustrated some of the problems encountered by minority shareholders in the governance of SOEs in Bulgaria by giving two practical examples, although it appeared that at least in one case minority shareholders could be successful with their claims. In this respect, the issue was raised by one participant whether minority shareholder protection in SOEs should go so far as to take precedence even over strategic interests of the government. The intervention of **Mr Enrique Sanchez-Armass** of the IFC on the success in the privatisation of Banca Comerciala Romana, which was only possible because of major changes that the bank first had made to its governance structure (eg a clear separation of management and supervisory board, super-majority requirements), raised particular interest.

Session 4 – The Role of Banks in Corporate Governance:

Both, in South East Europe and Eurasia, banks still play a far greater role in financing companies than capital markets. In this context, there would be interest in having banks take on greater responsibility not only for achieving a high level of corporate governance themselves, but also in influencing the corporate governance of the companies of which they were creditors. Those issues are discussed in this session, chaired by **Mr Aurelian Dochia**, Managing Director of BRD – Soci t  G n rale Group in Romania. The initial presentation by **Mr Kirk Odegard** of the Bank for International Settlements dealt with the amended Guidance on Enhancing Corporate Governance for Banking Organisations of the Basel Committee published in February 2006. He set out the reasoning for the work of the Basel Committee on the Guidance, the changes to the original guidance, the main content of the eight principles based on the OECD Principles, and the role of banking supervisors in this area.

Mr Motoyuki Yufu, Principal Administrator in the OECD, reported on the experience gained from the work of the Asian Corporate Governance Roundtable's Task Force on the Corporate Governance of Banks, which has been developing practical recommendations. **Mr Armen Mathevosyan** of Bank Republic, one of the largest banks in Georgia, agreed with the importance banks had for corporate governance in the region, since they were usually more advanced in their own corporate governance than was the case in other sectors. He also referred to Bank Republic, which was part of an IFC-funded programme to improve its corporate governance, as a good example for the financial benefits better corporate governance could bring to a company. **Mr Kenneth Bertsch** of Moody's Investors Service commented on the role of good corporate governance for banks from the viewpoint of a rating agency.

In the ensuing discussion, participants commented on the Basel Committee's Guidance and on the possible need to adapt them to the specific characteristics of transition countries. Finally, the question was raised to what extent corporate governance requirements could differ between listed and non-listed banks, as well as between listed companies and listed banks.

Second Day – 17 February 2006**Session 1 – Progress in Corporate Governance in South East Europe:**

The first session Day two of the South East Europe Corporate Governance Roundtable (“SEE Roundtable”), chaired by **Mr Rainer Geiger** of the OECD, discussed progress and future reforms, as well as remaining shortcomings in the priority areas identified in the SEE Roundtable’s White Paper (“White Paper”) launched in 2003. In his introductory remarks, Mr Geiger stressed the link between the SEE Roundtable and the Regional Programme of the Investment Compact. **Mr Alexander Karpf** of the OECD presented the main findings from some 20 responses to a questionnaire circulated among SEE Roundtable participants prior to the meeting regarding the implementation of the White Paper’s key priorities. First, it was clarified that the questionnaire was aimed at providing a basic overview of the status-quo and future projects in the field of corporate governance and did not constitute any ranking of countries, but simply served as an indicator of progress or lack of progress and a means for identifying possible priorities for the follow-up work of the SEE Roundtable. In the presentation, the overall results for the region were provided, in particular: (i) the White Paper and the OECD CG Principles formed benchmarks in the reform process both for regulatory and private-sector initiatives; (ii) the legal framework was rather advanced, however, implementation and enforcement were still weak; (iii) governments were overwhelmed by the extent of reforms, but were hesitant to rely on self-regulatory efforts as a complimentary route in the reform process; (iv) the awareness of stakeholders as to the importance of good corporate governance would still have to be raised; and finally, (v) co-ordination among national and international entities working in the area of corporate governance had to be improved. The second part of the presentation dealt with an outline of the results of the questionnaire for each key priority. **Mr Gian Piero Cigna** of the European Bank for Reconstruction and Development (“EBRD”) provided an overview of the results of the legal assessments of corporate governance law and practice in the latest EBRD Legal Indicator Survey. In his presentation, Mr Cigna explained the methodology used by EBRD in its assessment of effective disclosure and redress in SEE on the basis of a case study on related-party transactions, and what criteria were applied in measuring. As a main conclusion of his presentation, the laws on the books were considered good in most of the participating countries, given also the impact of the EU accession process. However, the effectiveness of redress mechanisms was still not satisfactory. A number of comments raised questions about the methodology used (relevance of the theoretical case used in SEE, representativeness and number of respondents, etc) and whether some of the more positive findings of the survey should have been more critical.

In the following panel discussion, one person per country presented the main developments, challenges and priorities in a short intervention. **Mr Plamen Tchipev** referred to the well-developed legal framework in Bulgaria and to the activities of the private sector, such as annual good corporate governance awards and the establishment of associations of shareholders as well as of an association of investor relations officers. He also proposed having the next SEE Roundtable meeting in Bulgaria. In the following intervention, **Mr Aurelian Dochia** suggested that Romania had made slow, but steady progress in its reform process, with the EU accession as a main driver. He also made reference to the problems related to the application of IFRS and the fact that numerous corporate governance codes had been developed in Romania, however without real impact due to the lack of co-ordination among the entities involved. Finally, he commented on the positive effects on companies’ governance approach because of their ever

increasing business relations with foreign companies. **Mr Gafur Luga**, Executive Director of the Albanian American Trade and Development Association of Albania, mentioned as main developments the establishment of the Albanian Forum on Corporate Governance, better training facilities and programmes (such as for accountants and auditors), and, more generally, government initiatives to cut red tape. In his view, the main obstacles to progress covered especially the area of enforcement, where improvements could be achieved by giving the securities regulator a broader scope (in particular, as to non-listed companies) and by raising the private sector's awareness.

Mr Andrej Galogaza, General Counsel of the Zagreb Stock Exchange, talked about the progress regarding the implementation of the White Paper recommendations in Croatia on the basis of a report he had prepared for the meeting. He summarised the main conclusions of the report, which concerned the need for: (i) improved co-ordination at the legislative and regulatory level, especially to avoid gaps and inconsistencies in the legal framework; (ii) reforms of the judiciary; (iii) better consultation practises and clear accountability of the securities regulator. He continued by suggesting that, since almost 50% of the White Paper recommendations were addressed to the lawmakers, big steps could only be made by the government and that the constituency of the SEE Roundtable should be extended accordingly. Mr Galogaza stressed the fact that not even corporate governance scandals had spurred a specific reaction from authorities, so that outside pressure could be most useful (OECD, Investment Compact, World Bank, IFC, EBRD, to mention some). On the positive side, he mentioned, in particular, the ongoing work on a corporate governance code, involving all key players in Croatia, and the more and more common practices of companies to adopt internal corporate governance codes.

Mr Samir Latif, Senior Legal Advisor of the USAID Macedonia Corporate Governance and Company Law Project, provided a brief outline of the recent developments in the Former Yugoslav Republic of Macedonia, which included a number of legislative measures (new company, securities and bankruptcy laws, on-going work on a corporate governance code, establishment of the Corporate Governance Council, etc). Obstacles concerned the weak enforcement by courts and the reluctance of boards to adapt to good corporate governance practices. Future priorities should especially be further efforts in awareness-raising among shareholders, a comprehensive judicial reform, as well as better training of accountants and auditors. **Mr Edib Basic**, Director at Deloitte d.o.o., did not see much progress in the reform process in Bosnia and Herzegovina, in particular, on the legislative level, even though disclosure of annual reports of listed companies and the framework for accounting and auditing had improved. The final intervention by a panel discussant, **Ms Lidija Seskar**, Legal Advisor of the Belgrade Stock Exchange, provided an overview of the situation in Serbia and Montenegro, where considerable progress on the legislative side could be noticed (eg takeover and investment funds laws, adoption of IFRS). She was, however, concerned about the increasing number of companies having been de-listed from the exchange, which – in her view – could be caused by minority shareholder provisions, viewed by companies as too extensive, and regarding which the government should counteract, for example, by providing tax incentives.

In the subsequent floor discussion, the fact that almost all participating countries had underdeveloped capital markets, where companies de-listed or did not want to get listed, was commented on. Some participants argued for better incentives from the government (tax, etc) for listed companies, others referred to the negative experience with such incentives or questioned the necessity to have more listed companies in the region as a condition for better corporate governance practices, also referring to the fact that many companies had not become

listed on a voluntary basis but following the mass privatisation programmes. However, the experience of the Bucharest Stock Exchange, where a significant number of companies had been de-listed, but turnover had increased almost eightfold within one year following the delisting, seemed to suggest that de-listing did not necessarily have to have a negative effect on volume and turnover of trading. In this context, it was also said that local companies were frequently subsidiaries of foreign companies, which preferred to use foreign, and not the small and illiquid SEE exchanges to raise capital.

Session 2 – The Securities Regulators’ Role in the Enforcement of Corporate Governance Rules:

In Session 2, chaired by **Mr Rudolf Müller**, Senior Counsellor in the Swiss State Secretariat for Economic Affairs, the improvements made and the remaining challenges in the region regarding the enforcement powers and practices of securities regulators in relation to corporate governance rules were discussed. **Mr David Robinett** of the World Bank Group began his presentation by pointing to some of the “myths” which were usually referred to in discussions on enforcement: (i) laws were good but enforcement was poor; (ii) one’s own courts were worse than anywhere else; (iii) one should look at alternative mechanisms for enforcement. He then provided an outline of the three main types of enforcement – private, self- and regulatory enforcement – including also their common shortcomings and referred to the results of the Doing Business survey on investor protection conducted by the World Bank Group in 2005. In the final part of the presentation Mr Robinett drew comparisons between different securities regulators, in particular, regarding the scope of their supervisory responsibilities, and emphasised the important role securities regulators should play in the enforcement of company law, and not just in securities law given the special situation in SEE.

Ms Vladislava Raikova, Head of Department in the Bulgarian Financial Supervision Commission, gave an overview of the powers and (educational) activities of the Commission in the field of corporate governance. **Mr Murat Dogu**, Corporate Governance Coordinator of the Turkish Dogan Media Group, provided his view on how to increase the effectiveness and efficiency of enforcement by securities regulators: (i) they should only regulate issues they would be able to enforce effectively; (ii) regulators should use a risk-based approach to enforcement; and (iii) they should possess sanctioning powers having a deterrent effect. **Mrs Dejana Suskavcevic**, CEO of the Montenegro Stock Exchange, noted that regulators should allow for active participation of all stakeholders in their enforcement activities, such as the stock exchanges that monitored markets and were therefore well-placed for detecting insider trading or market manipulation.

Participants also mentioned that regulators had wide powers, but those were often not used effectively. On the issue of giving greater powers to regulators regarding non-listed companies, as courts and other enforcement mechanisms did not play the role they should, it was argued that the risk of inconsistent enforcement and additional costs should be taken into consideration. Participants were of the view that good consultation practices of the securities regulators with the private sector and other interested parties were beneficial to the quality of regulation and the acceptance of new regulation by the industry. Finally, it was stressed that securities regulators in SEE should raise awareness and play an educational role, not only as to shareholders, but also the other stakeholders in corporate governance.

Session 3 – The Role of the Private Sector in the Enforcement of Corporate Governance Rules:

This session, chaired by **Mr Demir Yener**, Team Leader of the USAID Programme for Technical Assistance for Policy Reform in Egypt, addressed the responsibilities of the private sector for enhancing corporate governance, a key priority of the White Paper. In the presentation of **Mr Samir Latif**, the role of the board of directors in the development and implementation of corporate governance standards was the main topic. His presentation dealt with the effectiveness of boards of directors, the potential of boards in emerging markets and reform strategies, supported also by statistical material. Mr Latif finally touched upon the reform process in FYROM and the role boards played therein, but pointed out that changing the attitude of directors of the older generation had proven rather difficult. It was commented that experience in the Ukraine showed changes could materialise if the right incentives were there (eg demand for external financing).

Mrs Gratiela Iordache, Member of Parliament and Director of the Romanian Shareholders' Association, mentioned areas of progress in Romania which had been brought about by the activism of the Association's efforts (lawsuits, public campaigns, etc), but was nevertheless of the view that the government and authorities were best-placed for changing practices for the better (eg by restricting public procurement contracts to companies with good corporate governance). **Mr Stefan Petranov**, Chairman of the Board of the Golden Lev Capital Fund Management in Bulgaria, was of the view that, in general, the private sector could be beneficial to corporate governance reforms through self-regulatory efforts, thereby complementing the legal provisions, and, specifically, institutional investors could play an important role in requiring companies they invested in to change their governance. However, judging from experience in Bulgaria, he observed that despite legal requirements regarding corporate governance of companies (such as, corporate governance programmes and investors' officers being required for listed companies) their overall attitude towards the promotion of good corporate governance was passive. **Mr Andrew Wilson**, Senior Officer in the Center for International Private Enterprise, stressed the importance of creating demand from directors for changes in companies, in particular, by clearly stating the benefits, also in financial terms, to them.

In the floor discussion several participants proposed that the Roundtable should focus its efforts on raising the awareness of board members as to the need and, in particular, the benefits of good corporate governance of a company, as they were a crucial part of the reform process in SEE. The proposal of the Global Corporate Governance Forum, which referred to its toolkit for directors, to support a so-called "Companies Circle" with companies serving as success stories met great interest of participants. The IFC also announced that it would be pleased to support efforts to raise company awareness. Finally, the need for more attention to the media's role (including training of journalists) was emphasized, as well.