6th Meeting of the Eurasia Corporate Governance Roundtable

15 February 2006

Enforcement of Corporate Governance Rules

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

With the Support of
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The Global Corporate Governance Forum

Synthesis Note

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Istanbul, Turkey, 15 and 16 February 2006

Synthesis Note

The sixth meeting of the Eurasia Roundtable on Corporate Governance took place in Istanbul, Turkey, on 15 and 16 February 2006. (The second day of the meeting was held jointly with the South East Europe Corporate Governance Roundtable).

The main objective of the Roundtable was to support corporate governance improvements in the region by: (i) assessing recent corporate governance developments and future reforms in Eurasian countries; (ii) discussing ways to increase securities regulators' and the judiciary's effectiveness in the enforcement of corporate governance rules; and (iii) considering effective enforcement of the corporate governance framework through alternative dispute resolution mechanisms. In the joint meeting on the second 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.

In the concluding session, the Eurasia Roundtable participants agreed that, given that the banking sector is most developed in the region, it would be desirable to establish a Task Force. The Task Force would develop recommendations on the corporate governance of banks, taking into account both the OECD Principles of Corporate Governance and the Basel Committee's amended Guidance on Enhancing Corporate Governance for Banking Organisations. There was also consensus among participants that the involvement of companies in the work of the Eurasia Roundtable should become more active, both to have their valuable input to the work of the Roundtable and to provide a forum for companies serving as examples for the benefits of good corporate governance. In addition, participants asked that efforts be made to increase both the visibility of the Roundtable, in particular, through the involvement of high-level government officials and media, and its network character.

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.

The Roundtable gathered some 90 experts and policy-makers from the region (Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Mongolia, Ukraine and Uzbekistan), 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). For the joint meeting with the South East Europe Roundtable, some 120 participants were present, including members of FEAS from the MENA region.

The first day of the meeting was opened by **Mr Aril Seren**, Secretary General of FEAS; **Mr Murat Yalcıntaş**, Chairman of the Board of the Istanbul Chamber of Commerce; **Mr Tayfun Bayazit**, Vice Chairman of the Corporate Governance Association of Turkey; and **Mr Eimon Ueda**, Head of the OECD Outreach Unit for Financial Sector Reform. The second day of 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 – 15 February 2006

Session 1 – Recent Developments and Future Reforms:

Under the chairmanship of **Mr Philip Armstrong**, Head of the Global Corporate Governance Forum, this session discussed the major developments, remaining obstacles and future priorities in the area of corporate governance in the countries participating in the Eurasia Roundtable. **Mr Alexander Karpf** of the OECD recalled the main findings and reform priorities identified in the report "Corporate Governance in Eurasia: A Comparative Overview", which was launched in 2004 by the Roundtable. **Mr Gian Piero Cigna** of the European Bank for Reconstruction and Development 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 also explained the methodology used by EBRD in its assessment of effective disclosure and redress in Eurasia on the basis of a case study on related-party transactions, and what criteria had been applied. As a main conclusion of his presentation, and also subsequent remarks, the laws on the books were considered rather advanced in most of the participating countries, however, the effectiveness of redress mechanisms was still not satisfactory.

In the following panel discussion, one person per country presented the main developments in a short intervention. **Mr George Loladze**, Chairman of the Supervisory Board of the Georgian Stock Exchange, stressed the apparent policy change in Georgia in relation to corporate governance reforms, which was to reduce the amount of legislation and regulation to render the capital market more attractive. **Mr Nerses Yeritsyan** of the Central Bank of Armenia reported about the changes in the institutional (with the Central Bank having become the integrated financial regulator) and legal framework (a new government initiative on corporate governance). He referred to the need to drive the reform process further (eg by more diversified ownership structures of companies, greater numbers of institutional investors, common efforts across Eurasian capital markets to become more integrated) and to open the Eurasia Roundtable to private companies for their participation in order to receive their valuable input but also to be able to present success stories of companies in the region with good corporate governance. **Mr Mustafa Mammadov**, Vice-President of the Baku Stock Exchange, provided an overview of the recent developments in Azerbaijan, including a reform programme by the government, new regulations for corporate governance of banks and the securities sector. He also pointed out that the priority for future work on corporate governance issues in Azerbaijan should be education and training of the stakeholders in this field, and that it would be useful in this respect to have one of

the next meetings of the Roundtable in Azerbaijan. **Mr Iurie Tierda** of the National Securities Commission of Moldova presented the main changes in the legal framework regarding corporate governance and referred to the efforts, supported by the Financial Sector Reform and Strengthening Initiative, in creating a corporate governance code. **Mr Serhiy Biriuk**, Commissioner of the Ukrainian State Stock Market and Securities Commission, made reference to the problems caused by not having a joint-stock companies act and to the slow progress in other priority areas (in particular, the low level of disclosure by companies, the uncertainties created by two, partly inconsistent, codes of corporate governance and the serious deficiencies in the judicial enforcement), which posed also problems regarding the attractiveness of the Ukrainian capital market to foreign investors. **Mr Juruslan Toichubekov**, Director of the Kyrgyz Financial Agency, referred to the recent corporate governance programme and the existing shortcomings hampering greater interest from abroad in the Kyrgyz market. **Mr Bekhbat Sodnom** of the Working Group on Corporate Governance of the Mongolian Parliament mentioned some of the progress made over the last years (eg the creation of an integrated regulator, shareholders' increasing awareness regarding their rights), and also the numerous remaining shortcomings (eg high concentration of ownership, directors being considered as mere representatives of the controlling shareholders, lack of enforcement, limited capacities of the regulator), which should be addressed in the short term, especially through more training. In the intervention of **Mr Kamoliddin Tolipov**, Deputy Director General of the Uzbek Centre on Coordination and Control over the Functioning of the Securities Market, a number of improvements in relation to the implementation of the Roundtable's Comparative Overview reform priorities were set out, but also problematic areas, such as the lack of adequate control of the management board by the supervisory board or the limited disclosure by companies. In the final intervention, by **Ms Aklima Aripova** of the Management Development Center, the situation in Kazakhstan was discussed, with the main emphasis on the new corporate governance code developed by the private and public sector in the course of 2004. She saw an urgent need both in explaining the benefits of corporate governance to companies (for example, by identifying good examples and giving those more visibility, since companies are crucial to reforms in the field of corporate governance), and in strengthening the training and education programmes.

In the general discussion during Session 1, participants agreed that there should be more involvement from companies (including business associations) in the work of the Eurasia Roundtable. It was also stressed that it was not an easy task to explain to companies the benefits of good corporate governance, and in particular that those benefits outweighed the costs of compliance, and it was commented that the Roundtable should play a greater role at a regional level in this respect. The proposal to establish a so-called "companies circle" based on the experience of the OECD Latin American Corporate Governance Roundtable was widely supported, but it was acknowledged that there should be a minimum number of "model companies" participating in such a group to have meaningful discussions.

Another more general comment raised by a number of participants concerned the interest in increasing the involvement and participation of senior government officials in the Roundtable. The Roundtable discussions could inform governments on the substance of corporate governance issues, on the one hand, and the importance of corporate governance reforms, on the other hand. (Many governments would still focus their efforts on improving the investment climate to get more foreign direct investment, whereas functioning capital markets were not a priority on their agenda, yet.)

Awareness-raising was not considered satisfactory in participating countries, yet. It was suggested that the Roundtable should involve media more closely in its work, so that they understand corporate governance issues better, and to make the Roundtable's efforts and recommendations more visible among stakeholders in the region.

Participants also referred to the danger of overregulation in those emerging markets. Concern was expressed that governments might actually deviate from internationally accepted standards in the field of corporate governance, for example, to attract more companies to the exchanges or more generally to let the capital market develop itself before extensive regulatory intervention would take place. The discussions touched on the issues of the possible need to adapt international standards to local characteristics and better impact and cost-benefit analyses in the regulatory and supervisory practices, as well as the balance between the extent of regulation and its actual enforcement.

Regarding the development of corporate governance codes reported by a number of participating countries, the discussion in this area focused on the impact codes could have on improving the corporate governance framework. One conclusion drawn was that corporate governance codes could have an important function, but that voluntary codes and those that lack clarity as to their content might not add any value, as they did not constitute a proper substitute for legally binding rules.

Session 2 – Mechanisms for the Enforcement of Corporate Governance Rules:

In their introductory remarks, the co-chairs **Mr Aril Seren**, Secretary General of the Federation of Euro-Asian Stock Exchanges, and **Prof. Panayotis Alexakis**, Professor at the University of Athens and former CEO of the Athens Stock Exchange, stressed the importance of functioning and efficient enforcement mechanisms for the overall corporate governance culture. In the main presentation of this session dealing with different enforcement mechanisms, **Mr Henry Schiffman**, consultant with long experience in the region, the general message was that non-compliance and lack of enforcement even of basic corporate governance requirements, such as the right to attend a general shareholders meeting or to vote, were widespread in Eurasia. He then stressed some of the more problematic areas of enforcement. Regarding the role of shareholders, the lack of institutional investors and specialist advice as well as lack of trust in legal institutions were considered as main challenges. As to government regulators (such as securities commissions), these could play a more important role in the enforcement of company law (in addition to securities law) given the weaknesses of the judiciary, provided that they had the necessary powers and capacities, impose deterrent sanctions and concentrate on the important issues. The role assigned to boards in the exercise of their fiduciary responsibilities – as an additional way for enforcing corporate governance rules – was hindered by the dominance of controlling shareholders, but could be overcome, in particular, by requiring genuinely independent directors. Furthermore, Mr Schiffman commented on the possibilities of stock exchanges to improve enforcement (eg by introducing corporate governance rules in the listing requirements) and the role of courts, which he regarded most problematic in this field.

In the intervention of **Mr Yerlan Balgarin**, Managing Director of Centras Capital, the reasoning behind the work on a corporate governance code in Kazakhstan was explained in more detail. He also provided an analysis of how existing shortcomings in enforcement in Kazakhstan could be overcome: the number of joint-stock companies, to which the full corporate governance regime applied, should be reduced to cover only those that are listed on the exchange, and the benefits of

compliance with corporate governance rules should be explained to companies. **Mr Igor Belikov**, General Director of the Russian Institute of Directors, referred to the experience in Russia with the effectiveness of the Russian Corporate Governance Code, adopted in 2002 and endorsed by the Russian securities regulator. Despite improvements in enforcement in Russia, lessons to be drawn also in the Eurasian context concerned: need for deterrent sanctions in case of violations; consideration of possible conflicts of interest of stock exchanges with good corporate governance tiers when enforcing listing rules; and potential benefits for good corporate governance had to be clearly explained to companies.

Finally, the view was expressed that given the special circumstances in the region (in particular, the effects of mass-privatisation) special attention should be afforded to the corporate governance of non-listed companies, where enforcement could be more difficult than in listed companies, because courts, which were notoriously weak, were usually the competent authorities.

Session 3 – The Securities Regulators' and Judiciary's Role in the Enforcement of Corporate Governance Rules:

In the third session, chaired by **Prof. Panayotis Alexakis**, the focus was on the improvements made and remaining challenges in participating countries regarding the enforcement powers and practices of securities regulators and courts. **Mr Jens Fürhoff**, Head of Department of the German Federal Financial Supervisory Authority (BaFin), introduced the structure and powers of BaFin. The presentation focused on the responsibilities and the approach of BaFin in monitoring securities markets, covering insider dealing, price and market manipulation, ad-hoc disclosure and directors' dealings, as well as the notification requirements for major shareholdings.

Mr Mihail Buruiana, partner with Buruiana & Partners in Moldova, identified some of the main problems in relation to courts and regulators, namely the lack of experience, non-competitive salaries, and, related thereto, corruption. From his practical experience with court cases in Moldova, corporate governance provisions were often based on US or EU rules which gave wide discretion in their application to enforcers. This was a sensible approach in developed countries, however, in the situation of Eurasian countries with only very limited experience of courts in adjudicating such cases, discretion should be narrowed down. He also referred to the unique powers given to courts, which might render it difficult for other enforcement mechanisms to become suitable substitutes (eg arbitration). **Mr Valentyn Serdiuk**, Head of Department in the Supreme Court of Ukraine, informed participants about the difficulties courts face in the Ukraine in their work on corporate governance issues and the role of the Supreme Court. As an example of those problems, he referred to a case brought before the Supreme Court in which a court with general competence and a specialised, economic court gave contradictory rulings on the same issue and which the Supreme Court had to resolve. The last panel member to make introductory remarks in Session 3, **Ms Ayush Bazar**, Head of Department in the Mongolian Financial Regulatory Commission, introduced the role of this new Commission, which would have an intensive work programme for improvements in the regulatory field of corporate governance (eg financial and human resources, drafting of amendments to relevant laws, adoption of regulations, and raising public awareness). She also mentioned the need for assistance to regulatory authorities in the region, such as twinning programmes with Western regulators.

In the floor discussion, the question of publication of fines and sanctions was raised and whether this could improve their deterrent effect. In addition, comments concerned the benefits of creating integrated regulators (as was the case in Armenia, Kazakhstan, Kyrgyzstan, Mongolia, and Uzbekistan), which could include synergy effects but also greater power due to increased size and competencies.

Session 4 – Alternative Dispute Resolution Mechanisms:

Session 4, chaired by **Mr Jakob Simonsen**, UN Resident Coordinator and UNDP Resident Representative for Turkey, considered ways to improve enforcement of corporate governance rules through alternative dispute resolution (ADR) mechanisms. In the presentation of **Mr Alum Bati**, Partner with Salans LLP and Honorary Legal Advisor to the British Ambassador in Azerbaijan, the different ways of ADR were commented on, including a critical assessment of the role of courts in Eurasian countries. As a general point, he stressed that in the discussion of ADR mechanisms, and enforcement in general, the needs of stakeholders were often not adequately considered. Regarding the use of arbitration for the resolution of disputes related to corporate governance issues, he was rather pessimistic, in particular in relation to the difficulties when having to go through courts for the enforcement of an arbitral award. Mediation was considered an option, but would face its limits in cases of fraudulent and negligent acts. Ombudsman schemes, which played an important role in a number of developed countries, could be useful for minor cases, but would require a strong foundation of the scheme to resolve larger disputes. The preferred option of Mr Bati was the use of independent auditors for the review of corporate governance issues and the consideration of complaints, independently from its financial audit. In the comments from participants, the constraints to the use of auditors were pointed out, in particular, the reluctance of auditors to assume additional tasks, which involved questions of liability, their possible lack of expertise in corporate governance issues and, finally, the lack of enforcement powers of auditors.
In this respect, an alternative already in place in Russia was put forward, namely, that a company secretary or a committee comprising independent directors could be in charge of assessing the company's compliance with the applicable corporate governance provisions. However, some participants had doubts regarding their independence.

Mrs Natalia Galliamova, Vice-Chairman of the International Court of Arbitration in the Kyrgyz Republic, explained the situation on arbitration in Kyrgyzstan and made reference to the main disputes arising in the field of corporate governance. She also pointed out that arbitration could only take place where the parties to the dispute had concluded an arbitration agreement, which posed a problem regarding disputes involving shareholders (especially, since most companies' charters do not contain an arbitration clause). The possibility of requiring arbitration in the listing rules of exchanges was mentioned, which is already a practice in countries in other regions. In the intervention of **Ms Lada Busevac** of the International Finance Corporation ("IFC"), its project on mediation in the Western Balkans was presented in more detail, which was very successful in reducing the huge backlog of cases in the court system in Bosnia and Herzegovina, the Former Yugoslav Republic of Macedonia, as well as Serbia and Montenegro. Even though most of the cases brought to mediation concerned labour disputes, some lessons could be drawn for corporate governance disputes also in Eurasia, in particular, as an improvement of the judiciary would be a long-term process. Finally, she referred to a survey undertaken by the IFC in Bosnia and Herzegovina, which concluded that companies were favourable to the use of mediation for the resolution of corporate governance disputes. **Ms Marie-Laurence Guy** of the Global Corporate Governance Forum introduced the work undertaken by the Forum in relation to ADR.

Second Day – 16 February 2006

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

In the first session of the second day, 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 interventionalist 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 – Société Général 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.