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Notes for Remarks: A Boardroom Guide to the OECD Principles of Corporate Governance

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Session 4: *Improving Board Effectiveness: developing a boardroom guide to implementation of the OECD Principles, and the Latin American context*

The Latin American Corporate Governance Roundtable is organised by the Organisation for Economic Co-operation and Development in co-operation with the International Finance Corporation, World Bank Group

Introduction

- This is the third roundtable I have attended since the OECD constituted the Boardroom Guide Advisory Group. And I am pleased to have this opportunity to describe the project and at the same time invite your comments on the approach the Advisory Group is taking to the development of the Boardroom Guide.

- To give you some context for my remarks at the outset, what we are doing in the project involves an aspect of governance which is generic to all jurisdictions – and that is: what takes place or should take place in the boardroom. This is the focus of the Advisory Group and will be discussed in the Guide.

- I would appreciate your keeping this theme in mind as I make my remarks. At the conclusion, I will solicit your views on these questions.

My Background

- In order that you know where I am coming from when it comes to governance reform, I should say that my personal involvement is driven by a very commercial interest and my belief that governance can contribute to the creation of shareholder value; I am not a crusader.

- I sit on the boards of directors of four private sector companies, three of which are public, all of which are listed on the Toronto Stock Exchange and one is inter-listed on the New York Stock Exchange. My portfolio of boards, I expect, is about to be halved because two of the companies are subject to take-over bids which have been approved by the boards.

- As an aside – one of these companies has had some highly publicized governance issues involving the restatement of financial statements and allegations of insider trading; as the "poster boy" for corporate governance in Canada, I have assumed the chair of a committee of the board to address these governance issues; it has been a clinical exercise in learning how to walk the talk rather than talk the talk.

Background to the OECD Initiative

- The OECD decided in the late 90s that good corporate governance could contribute materially to financial market stability, investment and economic growth and initiated the process which produced the 1999 Principles.

- I was involved in the process that produced the 1999 OECD Principles as the representative from Canada (elaborate). Although I was an investment banker at the time, my firm volunteered my time to enable me to participate.

- The 1999 Principles were important for a number of reasons including:

  1. The adoption of the Principles by some 30 OECD member countries reinforced the universal belief in the importance of good corporate governance in the capital formation process.

  2. The Principles were also important because they underlined the significant role played by the infrastructure of governance and by this I mean the enactment by

the state of effective corporate laws, effective securities laws and the provision of an accessible and fair judicial system.

3. The Principles also reinforced the shared responsibility of both the private and public sector for developing a healthy governance climate in order to develop efficient capital markets.

U.S. Corporate Failures

- As capital markets globally began the process of formally relating good governance to corporate performance, we were confronted with the graphic challenge to the entire process of governance reform by the failures of a number of major U.S. corporations.

- These failures served to expose some of the limitations of corporate governance, that is to say, that corporate governance does not provide any guarantees about good corporate performance. Governance guidelines can only take us so far; the integrity of the people in the governance system is critical and no governance system can guarantee protection against fraud.

- The OECD observed the U.S. reaction and the reactions of jurisdictions elsewhere to these failures. The OECD recognized that, notwithstanding the limitations of corporate governance guidelines, the 1999 Guidelines should nevertheless be updated given developments elsewhere, made more specific and indeed I might say, more intrusive into the corporate decision-making process.

- Thus, the 2004 revision.

- The area which received most attention in the 2004 revision was Part VI – the responsibilities of the board of directors.

Reforms of Other Guidelines

- The 2004 revision has been very influential in forcing institutions, both public and private, to update their Guidelines.

- I will give one example. The ICGN, which is a network of institutional investors representing some several trillions of dollars of assets enacted governance guidelines at the same time as the OECD did in 1999; these Guidelines are particularly oriented to the interests of investors; I joined the board of the ICGN three years ago and chaired the committee of the ICGN to update its Principles of Corporate Governance to ensure that the ICGN Principles reflected the OECD reforms and any other reforms the ICGN membership believed was necessary.

- The OECD Principles have had a significant impact on this investor-driven organization and virtually all of the revisions to the OECD Principles have been reflected in the ICGN Principles. The revised ICGN Principles were adopted by the ICGN membership at its annual meeting in July of this year.

Reform Inside the Boardroom

- I think it is fair to observe that as a result of this recognition of the clear limitations of corporate governance, and in particular corporate governance guidelines, and

the recognition of the importance of the quality of the people in the system, the OECD starting thinking beyond guidelines and began thinking about what initiatives it could undertake to alter the focus from guideline reform to boardroom reform.

- There has been a recognition in the OECD that, at least for now, the guideline process has peaked and, if the OECD is going to continue to contribute to improving the quality of governance, the most effective way it can do so is by engaging in a process designed to assist those in the boardrooms to function more effectively – to give the guidelines some real boardroom texture.

- And I think it is fair to say that boards of directors are very receptive to this kind of initiative. Directors realize that guidelines can only take governance so far. Now it is up to boards to make them work.

- Advisory Group – And thus, the Advisory Group (6 members)

    - Composition (Ira Millstein – Chair, PJD & Dominique de la Garandarie, Vice Chairs, Gerhard Cromme, Sir Adrian Cadbury, Toyoo Gyoten – Japan, non-OECD), Holly Gregory, counsel

    - The process: consultation informally by participating in roundtables

    - Produce an outline

    - A broader consultative process in December (advisory group)

    - Publish a draft of the guide for comment

    - Finalize the document by mid-2006

- We have had a couple of meetings and already have a first draft of the boardroom manual. Part of my role as vice-chair of the Advisory Group is to hear from individuals involved in the governance process globally about the issues we should be addressing in the boardroom manual. I am going to give an outline of what issues I think we should address in a moment.

Criticism of Corporate Governance

- I also want to add that, without being so explicit, I think one of the motivating factors for the process for developing this boardroom guide, is the desire to respond to the criticism which is being levelled at the governance reform process.

- I hope I don't sound defensive in making these remarks but I think corporate governance is getting a particularly "bad rap" these days. Virtually every corporate failure or mishap is laid at the feet of corporate governance. It doesn't matter whether it's a full scale corporate collapse or a financial statement restatement or poor corporate performance or a romance involving an officer and an employee. If it costs shareholders value, poor corporate governance is to blame.

- Initially, I think those of us who believe in corporate governance should be flattered that the community believes that the influence of governance can be so

pervasive. But realistically, I think what this all inclusive attribution to corporate governance means is that we have to understand its limitations and ensure investors and other stakeholders likewise understand its limitations.

- There is no question that since the corporate failures of 2002 in particular, the corporate world has been focussed more on fiduciary governance, on compliance, and less on value-creating governance.

- In Canada we have had a couple of CEOs of major companies criticize the preoccupation of their boards of directors with corporate governance at the expense of focus on corporate strategy.

- I actually take this as a good sign in that CEOs are looking for their boards to focus more on corporate strategy than on fiduciary matters. The response to this concern, of course, is in the hands of the boards themselves. The chair of the board and the directors themselves can get organized so that they have more time to focus on strategy. As boards become more comfortable with the new governance environment, I believe that the board resources directed at fiduciary governance will recede and the proper balance between value-creating and fiduciary governance will return.

- Important to "have fun" as a director and the strategic component of a director's responsibilities satisfies that need.

Some of the Issues to be Addressed by the Advisory Group

- The Fiduciary Duty – Every discussion about effective governance has to begin with an understanding of the fiduciary duty of directors – the duty of loyalty, the duty of care. As we know, the corporate structure was created to facilitate capital formation for commercial activity; investors entrusting their capital to others to manage want to know that the "others" are subject to a fiduciary duty, otherwise the capital formation process will be compromised. Corporate governance, when boiled down, is all about helping directors discharge their fiduciary duties.

- One of the issues the Guide will address is the question of: to whom the directors owe their duty – to the corporation, to the shareholders, to all stakeholders. Each jurisdiction will have its own formulation and we will try to explain how directors act differently (if at all) depending upon the formulation.

- Independent Directors – Another principle that affects the constitution of boards of directors is the requirement that the board be independent of management. The objective oversight of management is achieved through various guidelines such as the requirement for a majority of independent directors, the requirement that new directors be recruited independently of management, the requirement that the board chair not be the CEO and so on. I think we need to look at how boards manage these requirements – in particular the construction of boards with virtually 100% (other than the CEO) definitionally independent directors. Is the board missing useful director resources by overreacting to the requirement for a majority of independent directors?

- I want to take a minute to highlight some of the other issues which will be discussed in the Boardroom Advisory Guide.

- "Tough" Board Issues – I have been asked to write an opening chapter in the manual identifying what I regard as the key challenges facing every board of directors. The thought is that this chapter will spark the curiosity of the reader and then the balance of the manual will provide tools and techniques for boards to respond to the issues raised by these challenges. So far, I have identified ten challenges which I am going to list with a brief commentary but I would welcome your contributions to this list or commentaries on how you think these issues should be addressed, either in the discussion following my presentation or informally outside this session.

1. What is the board's job?

- The nominee having done due diligence will have determined that he or she can make a contribution; having done so, he or she must have some idea as to his or her job as a director.
- But it's not always so clear.
- Boards don't take enough time to develop their mandate.
- A mandate does not mean a lot of vague language but language that is very specific to the corporation.
- Ultimately, the board's job is about what it can do to improve the performance of the corporation.

2. Developing and implementing a governance system

- A governance system is necessary to enable the board to function effectively.
- "The plumbing of governance".
- Keeping the governance system current (evaluations); removing a weak director; recruiting a new director.
- Succession at the board level.
- Board deciding on its own compensation.
- The big challenge, of course is, having designed the perfect system, making the system work.

3. Effective Board Leadership

- Non-executive chair.
- Chair responsible for setting the agenda and developing the boardroom atmosphere.
- Effective board meetings.
- Chair should complement CEO, not duplicate CEO.

- Establishing the proper oversight/ management balance in the relationship between the board and management.

4. The "Tone at the Top"

- Surpassing compliance.
- The board leads by example.
- Codes of conduct.
- The right tone at the top translates into shareholder value.

5. Overseeing Management

- Hiring and firing the CEO.
- Succession.
- Executive compensation.

6. Efficient Use of Limited Governance Resources

- Calendar for meetings.
- Meeting schedule.

7. Managing Information

- Dependency on management.
- User-friendly information.
- Don't take the board for granted.
- Sharing board expertise.
- "Power point".

8. Dissenting

- Departing from the consensus.
- Independent-minded directors.
- Accommodating a dissent.
- Dissenting from the majority shareholder.

9. A "Company-Defining" Decision

- Major transaction.
- The markets' opportunity to judge the merits of the board's decision.

- Reliance on experts.

10. Responding to Problems

- Problems: restatement; whistle-blower complaint; related party transactions; "red flags".
- Have appropriate governance resources in place.
- Displacing the regulator.

Closing

- These are examples of aspects of a director's life in which the Advisory Group has the opportunity to provide input and advice. The list of issues is in the process of being developed. The Advisory Group welcomes suggestions as to other issues facing directors which it should address.
- The Committee is made up of individuals with experience either as a director or working as an advisor with boards. The thinking which goes into the Advisory Guide will come, as well, from other individuals engaged in the governance process and we welcome your input.
- We all have governance war stories – some good, some bad. We're interested in pulling together all of these experiences in a user friendly way so that they provide guidance to boards on the application of governance guidelines.