



Corporate governance aspects of the crisis: OECD's experience

“The only constant is change itself!”

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This afternoon, I will cover...

1. Key issues arising from the financial crisis, as discussed by the OECD Steering Group on Corporate Governance
 - I. Risk management policies
 - II. Board practices
 - III. Governance of remuneration, incentive structures
 - IV. Role for shareholders

2. How our work is evolving, particularly in Asia
 - I. Global crisis needs global solutions: evolution of OECD's work and corporate governance standards since 1999
 - II. Need to restore confidence: critical time to review and evaluate existing standards and practices

The Six Chapters of the Principles(2004)

The full text of the Principles can be obtained from our website:

www.oecd.org/daf/corporate/principles

- I. Ensuring the basis for an effective corporate governance framework
- II. The rights of shareholders and key ownership functions
- III. The equitable treatment of shareholders
- IV. The role of stakeholders in corporate governance
- V. Disclosure and transparency
- VI. The responsibilities of the board

What are the major issues addressed by the revised Principles?

- Transparency and effective enforcement
- Ownership role of shareholders and institutional investors
- Protection of minority shareholders
- Conflicts of interest and financial market integrity
- The role of stakeholders
- Oversight by board

The OECD Principles seek to establish an effective system of checks and balances

- Between the board of directors and management: the *Principles* stress strategic guidance by the board and the oversight of internal control.
- But who monitors the monitors? The board is accountable to shareholders. The *Principles* emphasise the rights of shareholders, including to appoint and remove boards.
- In order to do their job, shareholder require high standards of transparency and disclosure.

Moving away from box-ticking: OECD Methodology for Assessing Implementation of the OECD Principles on Corporate Governance

- Background : OECD Steering Group decided to develop methodology, in line with practices of other international standard setters
- Objective : underpin an assessment of implementing the Principles and provide framework for policy discussions

Today's financial crisis

- Good corporate governance, especially in the financial sector, is one of the keys to healthy financial markets in today's globalised economy. Amid current market turmoil, OECD Secretary-General Angel Gurría has called for a new drive to raise standards and performance in this area.
- At the heart of this campaign will be moves to strengthen implementation of the [OECD Principles of Corporate Governance](#), adopted by the [Financial Stability Forum](#) as one of its 12 core standards for sound financial systems.

OECD calls for member countries to address major corporate governance failures

- “Rebuilding investor confidence will be vital to helping the economy get back on track,” Mr. Gurría told business leaders attending a meeting to discuss corporate governance issues last fall.
- “Strengthening the rules, regulations and codes of corporate governance will be central to this. I call on member countries to work urgently with us to address major corporate governance failures. This will be a vital step to reinforcing market integrity and implementation.”

The OECD Strategic Response to Crisis : Corporate Governance Aspects

- OECD Steering Group report highlighting main weaknesses in the financial sector and how to improve monitoring and implementation. (February 2009).
- Global Consultation and co-operation with other international organisations, non-member countries, business and stakeholders to discuss key weaknesses in corporate governance practices and joint efforts to improve monitoring and implementation of the OECD Principles. (March 2009).
- Progress report to the FSF meeting in Singapore and Report to the G20 meeting on “immediate actions”, including the results of the global consultation (April 2009).

The OECD Response cont. – mid term

- Report to OECD Ministerial Council Meetings, including a roadmap for mid-term actions to improve corporate governance (June 2009)
- Report and recommendations on effective implementation of risk management, board practices, governance of remuneration process and exercise of shareholder rights (November 2009)
- Thematic peer reviews on priority issues, ie implementation of risk management and quality of regulatory framework. 1st round (April 2010) / 2nd round (November 2010)
- Launch OECD web-based clearing house for regulatory impact analysis in the area of corporate governance (summer 2010)

OECD Steering Group Report : Corporate Governance Lessons from the Financial Crisis

- The financial crisis can be to an important extent attributed to failures and weaknesses in corporate governance arrangements.
- When put to a test, corporate governance routines did not safeguard against excessive risk taking.
- Weaknesses became apparent: risk management systems failed, board oversight was ineffective, remuneration systems were not closely related to strategy and risk appetite, shareholders unwilling or unable to act.

Refinement of corporate governance standards often follow a crisis

1. Burst of high tech bubble, pointed to severe conflicts of interests by broker and analysts. Financial crisis in late 1990s lead to development of global standards to restore confidence → OECD Principles on Corporate Governance.
2. Enron/Worldcom failures, pointed to auditor and audit committee independence and deficiencies in accounting standards and Parmalat/Ahold cases in Europe, pointed to major lessons leading to actions by IOSCO and national authorities → revision of OECD Principles.

How did the OECD get into the corporate governance business?

- Already back in 1998, an OECD Business Advisory group took out its crystal ball “The task of adapting, refining and adjusting corporate governance is a necessary and on-going process. To be competitive, both corporations and investors must be allowed to innovate relentlessly and to adopt their governance practices to new economic circumstances: corporate governance should be viewed as work in progress”.
- OECD member countries asked to develop Principles on Corporate Governance after the financial crisis in Asia, where the implications of a poor corporate governance framework and practices became evident.

Since their adoption by OECD member countries in 1999, the OECD Principles of Corporate Governance have become a global benchmark for policy dialogue

Governments

- 30 OECD member countries
- Numerous Security and Exchange Commissions, Stock Exchanges in non-member countries have developed codes

International Organisations

- Financial Stability Forum/principles
- The World Bank/ROSC assessment
- International Organisation of Securities Commissions (IOSCO)
- The Global Corporate Governance Forum

Private Sector

- International Corporate Governance Network (network of institutional investors with aggregate of \$10 trillion under management)

...A basis for policy dialogue OECD and Asian decision-makers to improve their corporate-governance framework and practices

Examples of 2003 Asian White Paper Recommendations*

OECD Principles of Corporate Governance

Asian Corporate Governance Roundtable

White Papers on Corporate Governance

Legal reforms

- Ensure that non-controlling shareholders are protected from exploitation by insiders and controlling shareholders
- Adopt international standards for accounting, audit and non-financial disclosure

Changes in Administrative Practice

- Strive for effective implementation and enforcement of corporate governance laws and regulations
- Intensify efforts to improve regulation and corporate governance of banks

Private Sector

- Raise awareness among companies, directors, shareholders and interested parties
- Board of directors must improve participation in strategic planning and monitoring of management

* Information on the Asian Corporate Governance Roundtable, as well as a copy of the White Paper, are available on line at: www.oecd.org/daf/corporate-affairs

OECD efforts in promoting CG reform worldwide

- No 'magic ball or one size fits all'policy dialogue via Roundtables established since 1999 in Russia, Latin America, Asia
- Organised by the OECD, in co-operation with the World Bank Group, and bilateral donors as well as regional development banks and local partners
- Developed recommendations with local ownership: Regional White Papers

The 2003 White Paper on Corporate Governance in Asia

- The White Paper was developed on a consensus basis by Asian decision-makers and international experts to formulate an action plan to improve corporate governance in Asia.
- White Paper quote: “The next phase of the Roundtable will focus on implementation and enforcement issues and include a stock-taking of developments and progress in two years time.”
- Priorities for Reform

The Stock-Take Report of the White Paper (Cont.)

The Report follows six priorities for reform of the White Paper

1. Awareness Raising
2. Implementation and Enforcement of Laws and Regulations
3. Convergence with International Standards for Accounting, Audit and Non-Financial Disclosure
4. Function of Boards of Directors
5. Protection of Non-Controlling shareholders
6. Corporate Governance of Banks

Priority 2 – Implementation and Enforcement

- Progress since 2003:
 - Regulatory capacity building
 - Adoption and implementation of (voluntary) codes
- Obstacles to progress:
 - Opaque regulatory frameworks
 - Costs
 - Political interference
 - Judiciary
 - Legal transplant
 - Box ticking
- Priorities for further improvement:
 - Accountability regulators
 - Division of responsibilities different enforcement bodies
 - Further strengthening regulatory capacity
 - Capacity/capability/structure judiciary
 - Prevention of political interference
 - Clarify status codes, best practices etc.

Priority 5: Ensure non-controlling shareholders are protected from exploitation by insiders and controlling owners

- Progress since 2003:
 - Proxy voting
- Obstacles to progress:
 - Opaque group structures
 - Ownership structures
 - Lack of shareholder activism by (institutional) investors
- Priorities for further improvement:
 - Introduction class action and derivative suit
 - Ownership restructuring
 - Mandatory disclosure underlying and interlocking shareholdings
 - Insider trading regulation

Moving from awareness raising to policy design, implementation and enforcement of reform priorities...

Objective

- Encourage use of the OECD Principles and adapt them to national priorities
- Provide forum to support viable and effective corporate governance reforms, by discussing and analysing policy options

Format

- Policy-dialogue to exchange experience
- Task Forces for in-depth analysis
- Topics should be tied to ongoing or planned initiatives

Outputs

- Conclusions from the discussions to provide background analysis and options for viable policy solutions.
- A review of corporate governance developments, with participation of OECD member countries.

Asia takes leadership on key issues, reaching beyond its borders

- The Asian Roundtable's Task Force on Related Party Transactions
- Important also for the OECD Steering Group on Corporate Governance

Asia : related party transactions

- Enforcement, opaque ownership, insufficient transparency, inequitable treatment of shareholders and weak board remains significant challenges.
- Abusive related party transactions are at the crux of these issues, remain one of most serious breaches of corporate governance in Asia and around the world, example of Samsung case.
- Abusive related party transactions = transactions between the company and related party (e.g. shareholder, director, manager or their relations) that are not conducted at arms-length or on market terms.

Practical Guide to curb abusive RPTs

- OECD and decision-makers from Asia launched new initiative in Hong Kong, China in May 2008
- Draft report and recommendations were discussed in Manila, Philippines February 2009 by the Asian Roundtable Task Force on RPT
- The Issues Paper from Manila will be discussed by the OECD Steering Group on Corporate Governance in April 2009

What happens next?

- Asian Roundtable annual meeting hosted by Philippines on 9-11 September 2009.
- Proposed issues : corporate governance lessons from the financial crisis for Asia, implementation of RPTs Guide, role of stock exchanges in promoting corporate governance and possible revision of the Asian White Paper.

Going forward : learning from Roundtable experiences

- Keep in mind the Roundtable goals
 - Self assessment and regional comparison of successes and areas requiring further effort
 - Knowledge sharing and networking among key regional decision makers
- Keep in mind the Roundtable format
 - Peer discussion among senior policy makers, experts and business, using the OECD Principles of Corporate Governance as a conceptual framework
- Tangible outputs developed on a consensus basis

Conclusion

- To prevent corporate misconduct while enhancing corporate value, to develop market confidence and regain stability in financial markets as well as to further economic growth, multilateral dialogue is needed to forge solutions for new challenges as they arise.
- The OECD's Steering Group on Corporate Governance and its regional networks provide a forum for this dialogue, based on objective analysis and established OECD instruments. To ensure its effectiveness, the dialogue includes prominent and influential policy makers, investors, corporations and other stakeholders globally.



Questions for the audience

- Implementation gap; how to close the gap between formal compliance and effective implementation; at national and corporate level
- Is it strictly an issue of enforcement or still a need to raise awareness: educate and communicate best practices
- How can OECD promote monitoring and improve its cooperation with major players



THANK YOU!

Please feel free to consult our website
www.oecd.org