COUNCIL

REVIEW OF THE OECD PRINCIPLES OF CORPORATE GOVERNANCE AND THE OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES: PROGRESS REPORT

(Note by the Secretary-General)

Meeting of the Council at Ministerial Level, 3-4 June 2015
Background Document

Item 3.4: Improving the business climate to promote responsible investment

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This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.
1. This progress report on the review of the OECD Principles of Corporate Governance and the OECD Guidelines on Corporate Governance of State-Owned Enterprises is made available to the 2015 Council meeting at Ministerial level as background information.

2. As mandated by the Council, reviews of the OECD Principles of Corporate Governance (the “Principles”) and the OECD Guidelines on Corporate Governance of State-Owned Enterprises (the “Guidelines”) were launched in 2014 and are close to completion. The texts of the revised draft Principles and Guidelines are expected to be approved by the Corporate Governance Committee in May 2015. It is proposed that the revised Principles will be embodied in a draft Recommendation of the Council on the OECD Principles on Corporate Governance, whereas the existing Recommendation of the Council on OECD Guidelines on Corporate Governance of State-Owned Enterprises [C(2005)47] be replaced by a new Recommendation of the Council, considering the extent of the changes made to the Guidelines. Both Recommendations will be considered by the Corporate Governance Committee for approval in May 2015 and transmission to the Council for adoption at its July 2015 session.

The revised OECD Principles of Corporate Governance

3. Good corporate governance underpins market confidence, integrity and efficiency and hence promotes investment and economic growth. The purpose of the OECD Principles is to help policymakers evaluate and improve the legal, regulatory, and institutional framework for corporate governance. This is primarily achieved by providing shareholders, financial intermediaries, service providers, board members and executives with the right incentives to perform their roles within a framework of checks and balances.

4. Corporate governance failures during the recent financial crisis have drawn the renewed attention of governments, regulators, companies, investors and the general public to the potential weaknesses in corporate governance systems and the threats posed to the integrity of financial markets.

5. The Principles were originally adopted by the Council in 1999 in response to a call by the OECD Council meeting at Ministerial level, to develop a set of corporate governance standards and guidelines [C(99)67]. Since then, they have come to enjoy worldwide recognition and have been endorsed as one of the Financial Stability Board (FSB)’s key standards for sound financial systems. The current revision of the Principles takes account of national experiences and changed circumstances in both the financial and corporate sectors since the Principles were last revised in 2004 [C(2004)61].

6. The FSB, in its February 2013 Thematic Review on Risk Governance, called on the OECD to review the Principles, taking into consideration the sound risk governance practices listed in the FSB review. At their 9-10 February 2015 meeting in Istanbul, G20 Finance Ministers and Central Bank Governors called on the OECD to submit the revised Principles by their September 2015 meeting, for transmission to the G20 Leaders Summit in November 2015. A draft of the new Principles was also discussed at the G20/OECD Corporate Governance Forum in Istanbul on 10 April 2015, and found broad support among participants.

7. The Principles provide guidance through recommendations and annotations across six chapters: I) Ensuring the basis for an effective corporate governance framework; II) The rights and equitable treatment of shareholders and key ownership functions; III) Institutional investors, stock markets and other

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The revised Principles maintain many of the recommendations from earlier versions as continuing essential components of an effective corporate governance framework. But they also introduce many new issues while bringing greater emphasis or additional clarity to others. Some of the key changes include:

- Following the financial crisis, increased emphasis is placed on supervision and enforcement, both public (through supervisory authorities) and private (through shareholder lawsuits). The governance of financial regulators, but also the role of stock exchanges, has received increased attention, including the increased need for international co-operation in the face of companies incorporating in and simultaneously listing on exchanges in two or more jurisdictions.

- Various provisions were updated with respect to the possibilities for shareholders to express their views and influence executive and board compensation ("say-on-pay"); to participate and vote in shareholder meetings without physical presence (remote electronic participation); and to strengthen the rules for approval of related-party transactions.

- A new chapter dealing with the role of incentives of financial intermediaries has been added to take into account the diminished incentives for many shareholders to take an active interest in the governance of the companies that they have, directly or indirectly, invested in. To promote alignment of incentives and manage conflicts of interest, increased disclosures are recommended for intermediaries and service providers such as institutional investors, asset managers and proxy advisors.

- More broadly, the revised Principles recognise recent trends to disclose, in addition to their financial statements, information on sustainability issues, payments to governments, political donations, beneficial ownership, related parties, and board member responsibilities. Internationally recognised accounting standards have been accepted much more widely than was the case in 2004, and many jurisdictions have established independent audit regulators.

- The revised Principles also provide increased guidance about the responsibilities of the board, including with regard to tax planning, risk management, and compensation. They also address the role of board committees, the internal audit function, board evaluation and training. Measures to enhance gender diversity in senior management and on corporate boards are mentioned, as is the role of board members appointed as employee representatives, where this is mandated.

- The revised Principles refer to other legal instruments as supplementary guidance in relevant areas, in particular the 2011 OECD Guidelines for Multinational Enterprises and the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.

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3 See document DAF/CA/CG(2015)7 (latest draft circulated to delegates).
The revised OECD Guidelines on Corporate Governance of State-Owned Enterprises

9. The OECD Guidelines on Corporate Governance of State-Owned Enterprises, adopted by the Council in 2005 as an integral part of the Recommendation of the Council on OECD Guidelines on Corporate Governance of State-Owned Enterprises [C(2005)47], provide a set of good practices on the legal and regulatory framework for state-owned enterprises (SOEs), the professionalisation of the state ownership function and the corporate governance arrangements of SOEs. A number of thematic and comparative studies developed on the basis of the earlier version of the Guidelines supported their revision, including in areas such as disclosure and transparency, public-private competition, board practices and funding and financing of SOEs. Building on the Working Party on State Ownership and Privatisation Practices’ knowledge of ownership practices in OECD Members and beyond, these studies highlighted areas that were deemed insufficiently covered by the existing Guidelines.

10. Moreover, the Guidelines have been increasingly used as a benchmark for SOE reform by Partner countries and jurisdictions, a number of which have engaged with the Working Party as Participants, and lessons learnt also supported the revision of the Guidelines. The revision of the Guidelines aims to ensure their relevance beyond the OECD membership and to provide useful guidance to countries at different levels of economic development.

11. The Guidelines cover the following areas: I) Rationales for State Ownership; II) The State’s Role as an Owner; III) State-Owned Enterprises in the Marketplace; IV) Equitable Treatment of Shareholders and Other Investors; V) Stakeholder Relations and Responsible Business; VI) Disclosure and Transparency; and VII) The Responsibilities of Boards of State-Owned Enterprises. Proposed changes to the Guidelines include:

- A new section on “Applicability and definitions” clarifies commonly used phrases in the context of SOE governance, such as ownership, control, economic activities, public policy objectives and boards of directors. The section also proposes guidance for determining which entities should be considered as “SOEs” — and thus governed to the standards set by the Guidelines — addressing elements such as an entity’s corporate form, commercial orientation and degree of government control. While the Guidelines focus on SOEs held by the central levels of government, they now also invite the ownership functions of subnational levels of government to implement as many of their recommendations as applicable.

- A new chapter dealing with the rationales for state ownership of enterprises has been added. It builds on existing guidance on the importance of developing an ownership policy, and places greater emphasis on the importance of identifying, disclosing and periodically reviewing the public policy rationales that motivate state enterprise ownership.

- A chapter dealing with the competition between SOEs and other enterprises has been significantly revised. It builds on existing text calling for a level playing field between SOEs and private enterprises, with more practical guidance concerning the cost and conditions of SOE financing, rate-of-return requirements, and public procurement procedures.


The text in all other chapters has been reviewed and revised to reflect the evolving international SOE landscape. Some changes of note include: greater attention to the importance of SOEs’ responsible business conduct; an explicit call to eliminate political donations by SOEs; additional guidance on achieving gender equality in SOE boards which builds on the Recommendation of the Council on Gender Equality in Education, Employment and Entrepreneurship [C/MIN(2013)5/FINAL]; and additional guidance on public-private partnerships and the management and disclosure of related risks. The revised Guidelines refer to other legal instruments as supplementary guidance including the 2011 OECD Guidelines for Multinational Enterprises.

The OECD Principles and Guidelines are global instruments

12. All G20 countries, as well as other non-Members represented in the FSB, participated in one or both review processes. Considering the status of the Principles as a “key standard” of the FSB, all FSB members were invited to contribute to the Committee’s and Working Party’s reviews on an equal footing.

13. Regarding the Principles review, eight Partners (Brazil; Colombia; Hong Kong, China; India; Indonesia; Latvia; the Russian Federation and Singapore) participated as Associates. The People’s Republic of China (China) also participated in the Principles review through the G20/OECD Corporate Governance Forum in Istanbul and by hosting a meeting in Beijing to discuss both the Principles and Guidelines. Another five Partners (Egypt, Lithuania, Malaysia, Saudi Arabia and South Africa) participated as Invitees. Experts from key international institutions, notably the Basel Committee, the FSB, and the World Bank also participated actively in the review. Consultations with Partners not directly participating in the Corporate Governance Committee were undertaken through the meetings of the Regional Corporate Governance Roundtables, through which the OECD promotes corporate governance reform. In addition to the regular Committee meetings, an expert consultation on the Principles review was held in connection with the March 2014 meeting, and a Special Session was held in February 2015. To help ensure their relevance to related policy communities, eleven OECD committees were also consulted.

14. Regarding the Guidelines review, Colombia, Latvia and the Russian Federation participated as Associates, while Argentina, Brazil, China, Costa Rica, Kazakhstan, Lithuania, Peru, the Philippines, South Africa and Ukraine participated as Invitees. The Working Party also invited comments from 14 OECD bodies and the Financial Action Task Force.

15. The two reviews have also benefited from open public consultations processes. Around 100 submissions were received from a variety of stakeholders, including national representatives from more than a dozen additional non-Members. Special consultations were also held with BIAC and TUAC throughout the process.

Chemicals Committee; Employment, Labour and Social Affairs Committee; Economic Policy Committee; Environment Policy Committee; Committee on Financial Markets; Committee on Fiscal Affairs; Committee for Industry Innovation and Entrepreneurship; Insurance and Private Pensions Committee; Investment Committee; Public Governance Committee; and Working Group on Bribery in International Business Transactions.

Competition Committee; Employment, Labour and Social Affairs Committee; Environment Policy Committee; Committee on Financial Markets; Committee for Industry, Innovation and Entrepreneurship; Insurance and Private Pensions Committee; Investment Committee; Public Governance Committee; Regulatory Policy Committee; Steel Committee; Trade Committee; Working Group on Bribery in International Business Transactions; and the Council Working Party on Ship Building.
Expected impact of the revised instruments

16. With the revised Principles and Guidelines, which will be, as foreshadowed, embodied in two new Recommendations of the Council, the OECD will extend its leadership in the area of corporate governance, and contribute to the OECD’s role as a global standard-setter in this field. By addressing key developments and concerns, for example with respect to the functioning of stock markets, the complexity of the investment chain, conflicts of interest and remuneration, their relevance and usefulness for national policy makers and international organisations has increased substantially. The explicit attention to policy priorities in emerging markets and the concrete input from Partners -- and particularly the partnership with G20 and FSB members in the review process – will further increase their global impact and use.

17. The revised Principles and Guidelines will provide improved and more widely used international standards for corporate governance. The use of the Principles will contribute to enhancing trust in the corporate sector and public stock markets. Effective implementation of the Principles may improve access to long-term risk capital for entrepreneurs and growth companies and provide more secure investment opportunities for households and institutional investors worldwide. In addition, the Guidelines will underpin better ownership and management of state-owned enterprises on a global basis, while fostering competitive neutrality between state-owned and private enterprises. Altogether, the Principles and Guidelines will provide for more open, efficient and equitable investment climate in national economies and the global market place.

18. The revised instruments will also provide important contributions to wider OECD initiatives, including but not limited to New Approaches to Economic Challenges (NAEC) and the Inclusive Growth initiative, the Trust Agenda and the Trust and Business project, and the OECD Strategy on Development. The Principles notably address issues that are crucial to increase investment in the corporate sector and access to capital markets for growth companies. The Principles’ reference to initiatives to enhance gender diversity on boards and in senior management will also contribute to the OECD’s Gender Initiative to support gender equality in employment, education and entrepreneurship. The implementation of the Guidelines is furthermore the subject of a separate activity entitled State-Owned Enterprises in the Global Marketplace.\footnote{8}

19. Avenues for promoting dissemination and implementation of the revised Principles and Guidelines will include the OECD’s own Peer Reviews, as well as country Economic Surveys and other relevant OECD sectoral policy reviews. The implementation of the Principles will also continue to be reviewed by the World Bank through Reports on the Observance of Standards and Codes (ROSCs), thus ensuring high visibility and a continued and strengthened role as an international benchmark. The peer reviews are designed to review country practices, identify weaknesses and disseminate good practices in the areas covered by the Principles. Reviews of implementation of both the Principles and the Guidelines also play an important part in the accession process to the OECD. The Guidelines are increasingly used as a basis for country SOE reviews under the auspices of the Working Party, and they are frequently used by Partners as a starting point for national reform efforts. Another avenue for implementing the Guidelines will consist in occasional national requests for the OECD to advise (in the past including Kazakhstan, Mexico, Slovenia and Ukraine) on urgent or ongoing SOE reform priorities. Regular monitoring reports will also be provided to the Council.

20. Implementation of the Principles and Guidelines will also be supported by, and contribute to, a rich wealth of new data and evidence. Country-level data on legal and regulatory provisions will also be collected and disseminated through the online Corporate Governance Factbook for easy comparison of

country policies and practices. Corporate level data will be collected, analysed and disseminated in order to provide policy advice on the impact of corporate governance policies on investment and access to capital, including for small and medium size growth companies. The Guidelines will serve as an organising principle for building a unique OECD database comparing national competitive neutrality practices and other topics of interest to the trade, investment, competition and corporate governance policy communities.