Report to G20 on the implementation of the G20/OECD Principles of Corporate Governance

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The G20/OECD Principles of Corporate Governance: An international standard put to active use

The *G20/OECD Principles of Corporate Governance* were endorsed by the G20 Leaders in 2015. They are primarily directed to policy makers and regulators, helping them to shape a legal and regulatory framework that supports investment, business sector dynamics and financial stability.

The G20/OECD Principles establish recommended practices and expectations with respect to shareholder rights, the role of stakeholders, the responsibilities of the board of directors and disclosure. They also address the underpinnings of effective capital markets and the role of institutional investors and market intermediaries. The development of the G20/OECD Principles was supported by extensive work to map and understand the reality of the business environment and the capital markets to which the G20/OECD Principles are to be applied. A number of empirical and analytical reports were prepared to inform the drafting. As a result, the G20/OECD Principles are well adapted to key developments in today's markets and to the challenges and opportunities that come with them.

The G20/OECD Principles reflect the fact that capital markets in general, and stock markets in particular, during the past 20 years have undergone profound changes. Different forms of institutional ownership have increased in importance at the expense of direct ownership by individual households; new investment strategies and investment vehicles, such as index investment and exchange traded funds, have become much more common; and, the business models of stock exchanges have been fundamentally transformed as many exchanges have become profit-maximising corporations that are themselves listed corporations.

Another important feature is the rapid growth of Asian stock markets—both in absolute and in relative terms. Data from 2017 concludes that Asian companies have become the world's largest users of public equity financing. As a consequence, stock exchanges and investment banks in Asia are important actors in what today are globally connected capital markets. Thousands of Asian companies are listed or traded on markets other than their local exchanges, and investment banks from non-Asian markets play a significant role in Asian markets together with other globally active intermediaries and service providers. Importantly, household savings in other parts of the world are increasingly channelled to Asian companies and markets via pension funds, insurance companies and other collective investment vehicles.

The global integration of capital markets provides important possibilities for companies to seek finance from a much larger pool of investors who in turn will be able to grasp investment opportunities beyond their own national borders. But it also leads to increased interdependence between investors and corporations that come from countries with different legal, regulatory, economic and cultural traditions. So in order to reap the full benefits of capital market integration, policy makers, regulators, market participants and stakeholders require a common language in terms of corporate governance. This is provided by the practices and expectations that have been agreed in the G20/OECD Principles.

Box 1. Promotion and implementation of the G20/OECD Principles

As the standard-setting body, the OECD and the Corporate Governance Committee under the Chairmanship of Mr. Masato Kanda are responsible for ensuring that the G20/OECD Principles are put to active use. This work benefits greatly from the contribution that comes with the active participation of all G20 countries as well as the engagement of the World Bank and the Financial Stability Board (FSB).

As a first step to facilitate the implementation of the G20/OECD Principles, the OECD, with participation of the World Bank, issued the Methodology for Assessing the Implementation of the G20/OECD Principles of Corporate Governance. The methodology was welcomed by the G20 in 2017. The methodology serves as a guide for assessing the regulatory framework against the Principles and has frequently been used by the World Bank in their reports on the observance of standards and codes (ROSC), which are carried out on the basis of the G20/OECD Principles.

The G20/OECD Principles have been adopted as one of FSB's key standards for sound financial systems and they are used for reviews under the auspices of the FSB. For example, the FSB examines the implementation of the G20/OECD Principles by taking stock of how FSB member jurisdictions have applied them to publicly listed, regulated financial institutions. This allows the FSB to identify effective practices and areas where progress has been made while noting gaps and areas of possible weakness.

The OECD has established an ambitious programme to support the use and implementation of the G20/OECD Principles worldwide. The purpose is both to review existing practices and to support national initiatives to meet the practices and expectations of the G20/OECD Principles.

At the heart of OECD's efforts to monitor and promote the implementation of the G20/OECD Principles are its regular thematic peer reviews. In 2018, the OECD Committee concluded an extensive peer review on the implementation of flexibility and proportionality practices in corporate governance. The review covered seven regulatory areas and 39 OECD and G20 jurisdictions. In 2019, the OECD Committee is undertaking a thematic peer review on the duties of boards in company groups.

The OECD Asian Roundtable on Corporate Governance closely follows developments in 17 Asian jurisdictions. Participants in this work are senior policy makers, regulators and stakeholders from Asia and beyond. Building on empirical and analytical research, the Asian Roundtable continuously identifies reform priorities and monitors progress with respect to their implementation. Areas that recently have been scrutinised include: disclosure of beneficial ownership, related party transactions and the evolving role of stock exchanges.

The OECD Latin American Corporate Governance Roundtable and its Task Force on Equity Market Development provides regional support for implementation of the G20/OECD Principles. The Roundtable has helped to build consensus in the region for a range of corporate governance reforms, for example, to support more effective oversight of related party transactions, and the adaptation of regulatory frameworks to facilitate equity market development.

A MENA-OECD Working Group on Corporate Governance has been established to support the implementation of the G20/OECD Principles in the Middle East and North Africa. In 2019, the MENA Working Group issued the report *Corporate Governance in MENA: Building a Framework for Competitiveness and Growth*. Scrutinising existing practices and regulations, the report identifies reform priorities that would improve corporate access to finance; transparency and disclosure; gender balance in corporate leadership, and; the corporate governance of state owned enterprises.

The OECD Committee is also engaged in policy dialogue with individual countries. Several countries have solicited the expertise and experience from their OECD Committee peers and the OECD Secretariat to inform their national reform agendas. Using the G20/OECD Principles as the benchmark, this co-operation has often led to concrete improvements in national regulatory frameworks. Most recently, the OECD Committee delegates and the OECD Secretariat have been working with the Brazilian authorities to support their objective of strengthening their framework for the enforcement of shareholder rights.

The G20/OECD Principles are a core benchmark in the OECD accession reviews. Countries seeking to join the OECD must demonstrate their willingness and ability to implement the G20/OECD Principles as part of their accession processes. This has led to countries like Colombia (which signed an accession agreement in May 2018) and Costa Rica (whose accession process is pending) completely overhauling their national corporate governance codes. Latvia, another recent OECD member, substantially reformed requirements for review of related party transactions. Additional non-OECD countries have become Adherents to the Principles.

The OECD Committee keeps a constant eye on market developments that may affect implementation. An important part of the OECD Committee's mandate is to improve the capacity of policy makers to identify market developments that may influence the effectiveness and relevance of existing corporate governance policies and practices. For this purpose, the OECD Committee continuously carries out empirical and analytical work that informs policy makers and regulators about ongoing trends and adapting the implementation of the G20/OECD Principles to new circumstances. Examples of such work include the mapping of ownership patterns in listed companies, the use of digital technologies and developments with respect to corporate bondholder rights.

The OECD Corporate Governance Factbook as a monitoring and implementation tool

An important and unique tool for monitoring the implementation of the G20/OECD Principles is the *OECD Corporate Governance Factbook* (the "Factbook"), which is issued every second year. The 2019 edition contains comparative data and information across 49 different jurisdictions including all G20, OECD and FSB members. The information is presented and commented in 40 tables and 51 figures covering a broad range of institutional, legal and regulatory provisions. The Factbook is actively used by governments, regulators and others for information about implementation practices and developments that may influence their effectiveness. It is divided into five chapters addressing: 1) the corporate and market landscape; 2) the corporate governance framework; 3) the rights of shareholders and key ownership functions; 4) the corporate boards of directors; and 5) mechanisms for flexibility and proportionality in corporate governance.

The corporate and market landscape

Effective design and implementation of corporate governance rules requires a good empirical understanding of the ownership and business landscape to which they will be applied. The first chapter of the Factbook therefore provides an overview of ownership patterns around the world, with respect to both the categories of owners and the degree of concentration of ownership in individual listed companies. Since the G20/OECD Principles also include recommendations with respect to the functioning of stock markets, it also highlights some key structural changes with respect to stock exchanges.

The OECD Equity Market Review of Asia (OECD, 2018a) reported that stock markets have undergone profound changes during the past 20 years. Globally, one of the most important developments has been the rapid growth of Asian stock markets—both in absolute and in relative terms. In 2017, a record number of 1 074 companies listed in Asia, almost twice as many as the annual average for the previous 16 years. Of the five jurisdictions that have had the highest number of non-financial company IPOs in the last decade, three are in Asia. In 2017, Asian non-financial companies accounted for 43% of the global volume of equity raised. The proportion attributable to European and US companies has declined during the same period. In terms of stock exchanges, by total market capitalisation, four Asian exchanges were in the top ten globally (Japan Exchange Group, Shanghai Stock Exchange, Hong Kong Exchanges and Clearing Limited, and Shenzhen Stock Exchange).

With respect to ownership patterns at the company level in the world's 50 000 listed companies, a recent OECD study (De la Cruz et al., forthcoming) reports a number of features of importance to policy-making and implementation of the G20/OECD Principles. The report, which contains unique information about ownership in companies from 54 jurisdictions that together represent 95% of global market capitalisation, shows that four main categories of investors dominate ownership of today's publicly listed companies. These are: institutional investors, public sector owners, private corporations, and strategic individual investors. The largest category is institutional investors, holding 41% of global market capitalisation. The second largest category is the public sector, which has significant ownership stakes in 20% of the world's listed companies and hold shares representing 13% of global market capitalisation. With respect to ownership in individual companies, in half of the world's publicly listed companies, the three largest shareholders hold more than 50% of the capital, and in three-quarters of the world's public listed companies, the three largest owners hold more than 30%. This is to a large extent attributable to the growth of stock markets in Asian emerging markets.

Stock exchanges have also undergone important structural changes in recent years, such as mergers and acquisitions and demutualisations. Out of 52 major stock exchanges in 49 jurisdictions, 18 now belong to one of four international groups. Thirty-three (63%) of these exchanges are either self-listed or have an ultimate parent company that is listed on one or more of its own exchanges. The Factbook's review of data from these 49 jurisdictions finds that more than 62% of market capitalisation is concentrated in the five largest stock exchanges, while more than 95% is concentrated in the largest 25. The top 25 highest valued exchanges include 11 non-OECD jurisdictions.

The corporate governance framework

An important bedrock for implementing the Principles is the quality of the legal and regulatory framework, which is consistent with the rule of law in supporting effective supervision and enforcement.

Against this background, the Factbook monitors who serves as the lead regulatory institution for corporate governance of listed companies in each jurisdiction, as well as issues related to their independence. Securities regulators, financial regulators or a combination of the two play the key role in 82% of all jurisdictions, while the Central Bank plays the key role in 12%. The issue of the independence of regulators is commonly addressed (among 86% of regulatory institutions) through the creation of a formal governing body such as a board, council or commission, usually appointed to fixed terms ranging from two to eight years. In a majority of cases, independence from the government is also promoted by establishing a separate budget funded by fees assessed on regulated entities or a mix of fees and fines. On the other hand, 25% of the regulatory institutions surveyed are funded by the national budget.

Since 2015 when the G20/OECD Principles were issued, 84% of the 49 surveyed jurisdictions have amended either their company law or securities law, or both. Nearly all jurisdictions also have national codes or principles that complement laws, securities regulation and listing requirements. Nearly half of all jurisdictions have revised their national corporate governance codes in the past two years and 83% of them follow a "comply or explain" compliance practice. A growing percentage of jurisdictions – 67% – now issue national reports on company implementation of corporate governance codes, up from 58% in 2015. In 29% of the jurisdictions it is the national authorities that serve as custodians of the national corporate governance code.

The rights and equitable treatment of shareholders and key ownership functions

The G20/OECD Principles state that the corporate governance framework shall protect and facilitate the exercise of shareholders' rights and ensure equitable treatment of all shareholders, including minority and foreign shareholders.

Chapter 3 of the Factbook therefore provides detailed information related to rights to obtain information on shareholder meetings, to request meetings and to place items on the agenda, and voting rights. The chapter also provides detailed coverage of frameworks for review of related party transactions, triggers and mechanisms related to corporate takeover bids, and the roles and responsibilities of institutional investors.

All jurisdictions require companies to provide advance notice of general shareholder meetings. A majority establish a minimum notice period of between 15 and 21 days, while another third of the jurisdictions provide for longer notice periods. Nearly two-thirds of jurisdictions require such notices to be sent directly to shareholders, while all but four jurisdictions require multiple methods of notification, which may include use of a stock exchange or regulator's electronic platform, publication on the company's web site or in a newspaper.

Approximately 80% of jurisdictions establish deadlines of up to 60 days for convening special meetings at the request of shareholders, subject to specific ownership thresholds. This is an increase from 73% in 2015. Most jurisdictions (61%) set the ownership threshold for requesting a special shareholder meeting at 5%, while another 32% set the threshold at 10%. Compared to the threshold for requesting a shareholder meeting, many jurisdictions set lower thresholds for placing items on the agenda of the general meeting. With respect to the outcome of the shareholder meeting, approximately 80% of jurisdictions require the disclosure of voting decisions on each agenda item, including 59% that require such disclosure immediately or within 5 days.

The G20/OECD Principles state that the optimal capital structure of the company is best decided by the management and the board, subject to approval of the shareholders. This may include the issuing of different classes of shares with different rights attached to them. In practice, all but three of the 49 jurisdictions covered by the Factbook allow listed companies to issue shares with limited voting rights. In many cases, such shares come with a preference with respect to the receipt of the firm's profits.

Related party transactions are typically addressed through a combination of measures, including board approval, shareholder approval, and mandatory disclosure. Provisions for board approval are common; two-thirds of jurisdictions surveyed require or recommend board approval of certain types of related party transactions. Shareholder approval requirements are applied in 55% of jurisdictions, but are often limited to large transactions and those that are not carried out on market terms. Nearly all jurisdictions require disclosure of related party transactions, with 82% requiring use of International Accounting Standards (IAS24), while an additional 8% allow flexibility to follow IAS 24 or the local standard.

The Factbook provides extensive data on frameworks for corporate takeovers. Among the 46 jurisdictions that have introduced a mandatory bid rule, 80% take an *ex-post* approach, where a bidder is required to initiate the bid after acquiring shares exceeding the threshold. Nine jurisdictions take an *ex-ante* approach, where a bidder is required to initiate a takeover bid for acquiring shares which would exceed the threshold. More than 80% of jurisdictions with mandatory takeover bid rules establish a mechanism to determine the minimum bidding price.

Considering the important role played by institutional investors as shareholders of listed companies, nearly all jurisdictions have established provisions for at least one category of institutional investors (such as pension, investment or insurance funds) to address conflicts of interest, either by prohibiting specific acts or requiring them to establish policies to manage conflicts of interest. Three-fourths of all jurisdictions have established requirements or recommendations for institutional investors to disclose their voting policies, while almost half require or recommend disclosure of actual voting records. Some jurisdictions establish regulatory requirements or may rely on voluntary stewardship codes to encourage various forms of ownership engagement, such as monitoring and constructive engagement with investee companies and maintaining the effectiveness of monitoring when outsourcing the exercise of voting rights.

The corporate board of directors

The G20/OECD Principles require that the corporate governance framework ensures the strategic guidance of the company by the board and its accountability to the company and its shareholders. The most common board format is the one-tier board system, which is favoured in twice the number of jurisdictions that apply two-tier boards (supervisory and management boards). A growing number of jurisdictions allow both one and two-tier structures.

Almost all jurisdictions require or recommend a minimum number or ratio of independent directors. Definitions of independent directors have also been evolving during this period: 80% of jurisdictions now require directors to be independent of significant shareholders in order to be classified as independent, up from 64% in 2015. The shareholding threshold determining whether a shareholder is significant ranges from 2% to 50%, with 10% to 15% being the most common.

Recommendations or requirements for the separation of the board chair and CEO have doubled in the last four years to 70%, including 30% required. The 2015 edition of the Factbook reported a binding requirement in only 11% of the jurisdictions, with another 25% recommending it in codes.

Nearly all jurisdictions require an independent audit committee. Nomination and remuneration committees are not mandatory in most jurisdictions, although more than 80% of jurisdictions at least recommend these committees to be established and often to be comprised wholly or largely of independent directors.

Requirements or recommendations for companies to assign a risk management role to board level committees have sharply increased since 2015, from 62% to 87% of surveyed jurisdictions. Requirements or recommendations to implement internal control and risk management systems have also increased significantly, from 62% to 90%.

While recruitment and remuneration of management is a key board function, a majority of jurisdictions set forth a requirement or recommendation for a binding or advisory shareholder vote on remuneration policy for board members and key executives. And nearly all jurisdictions surveyed now have a requirement or recommendation for the disclosure of the remuneration policy and the level/amount of remuneration at least at aggregate levels. Disclosure of individual levels is required or recommended in 76% of jurisdictions.

A growing number of jurisdictions have adopted measures to promote gender balance on corporate boards and in senior management, most often via disclosure requirements and measures such as mandated quotas and/or voluntary targets. Nearly half of surveyed jurisdictions (49%) have established requirements to disclose gender composition of boards, compared to 22% with regards to senior management. Nine jurisdictions have mandatory quotas requiring a certain percentage of board seats to be filled by either gender. Eight rely on more flexible mechanisms such as voluntary goals or targets, while three resort to a combination of both. The proportion of senior management positions held by women is reported to be significantly higher than the proportion of board seats held by women.

Mechanisms for flexibility and proportionality in corporate governance

It has already been pointed out that effective implementation of the G20/OECD Principles require a good empirical understanding of economic realities and adaption to changes in corporate and market developments over time. The G20/OECD Principles therefore state that policy makers have a responsibility to put in place a framework that is flexible enough to meet the needs of corporations that are operating in widely different circumstances, facilitating their development of new opportunities and the most efficient deployment of resources. The 2019 Factbook therefore provides a special chapter that presents the main findings of a complementary OECD review of how 39 jurisdictions apply the concepts of flexibility and proportionality across 7 different corporate governance regulatory areas. The chapter builds on the 2018 OECD report *Flexibility and Proportionality in Corporate Governance* (OECD, 2018b). The report finds that a vast majority of countries have criteria that allow for flexibility and proportionality at company level in each of the seven areas of regulation that were reviewed: 1) board composition, board committees and board qualifications; 2) remuneration; 3) related party transactions; 4), disclosure of periodic financial information and ad hoc information; 5) disclosure of major shareholdings; 6) takeovers; and 7) pre-emptive rights. The report also contains case studies of six countries, which provide a more detailed picture of how flexibility and proportionality is being used in practice.