OECD PRINCIPLES OF CORPORATE GOVERNANCE

DRAFT FOR PUBLIC COMMENT – NOVEMBER 2014

Comments by Pakistan Institute of Corporate Governance – January 2, 2015

Introduction:

Despite the far-reaching impact of the current global financial crisis and the now generally acknowledged need as well as importance of corporate governance to be treated in a more stakeholder inclusive manner, a shareholder-centric approach to corporate governance is still quite common in many jurisdictions. The OECD principles have managed to align these variations and the recent proposed revision further attempts to do so to a large extent. PICG has previously sent comments on the revision to OECD Principles in December 2013. This was further discussed and deliberated upon at the OECD Asian Roundtable session held in Mumbai in February 2014. (Session 3– Small groups’ discussions on the revision of the OECD Principles of Corporate Governance).

Principle 1

Comments:

We agree with the changes to the Principle. As stated in the preamble that the Principles serve to contribute to economic efficiency, sustainable growth and financial stability, what is crucial to consider are the words ‘ensure effective supervision and enforcement’ Without adequate enforcement of the principles it would be difficult to ensure sound applicability of these throughout the corporate governance framework consisting of organizations based on different models and structures. As stated previously in our comments there is no single model of good corporate governance. The Principles are formulated on some common elements of corporate governance that exist in most jurisdictions and embrace the different models that exist. The change suggested to the Principle will in turn compliment all the 4 pillars of Corporate Governance, Accountability, Fairness, Transparency and Responsibility. Also noteworthy is the
replacement of the words 'corporate governance system' with 'corporate governance framework'.

Regarding enhancement of cross-border cooperation it is important to note that enforcement cooperation is among the top priorities that facilitate the movement of capital across borders and increased investment opportunities for investors. Moreover strong international cooperation is vital to effective and appropriate resolution of international enforcement investigations also.

Principle II

Comments:

The Principle calls for a stronger role for shareholders in a number of important areas. Firstly the addition of the words 'AND EQUITABLE TREATMENT' in the title of the Principle itself sets the scene. The equitable treatment of shareholders is fundamental for investor protection, permeating in all aspects of an effective corporate governance framework. The equitability principle is important because it lays down the equitable treatment of shareholders according to the nature, content and amount of shareholdings and safeguards against unfair and inequitable treatment on the basis of relationships between the company and shareholders and between different shareholders. The purpose of protection is to close the gap and restore fairness. The equitable treatment of shareholders prohibits inequitable treatments without proper reason.

Accountability to shareholders is important and also the responsibility for a company's adherence to a high standard of corporate behaviour and ethics. It is crucial to state whether the corporate governance framework separately identify the need for the state as a shareholder to act in the best interests of the company?\(^1\) What may be considered is an appropriate amendment in paragraph 16. Additionally, when discussing specialized court procedures in paragraph 18, it may be desirable to include alternate dispute resolution mechanisms that are effective for non-controlling shareholders to seek effective redress for violation of their rights.

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1 Principle I (paragraph 2) OECD Principles of Corporate Governance ïDraft for public comment November 2014. A framework leaves room for tools and practices to be included but provides much of the process required on its own; on the other hand a system refers to set principles and practices which can be used to guide processes to achieve a particular goal.  
2 This was raised by PICG at the session held in February 2014 at Mumbai at the Asian Roundtable on Corporate Governance.
Principle III

Comments:

This is a newly added (and much needed) principle on institutional investors, stock markets, and other intermediaries and much desired. Investor protection turns out to be quite significant as in many countries expropriation of minority shareholders and creditors by the controlling shareholders is extensive. When outside investors provide equity and finance, they face a risk, and sometimes an inevitable fact that the returns on their investments will never materialize because the controlling shareholders or managers expropriate them.

Principle IV

Comments:

We agree with the changes suggested to the Principle. However, there is a need for a collaborative approach towards business which invariably drives the integration of economic and environmental policies leading to the development of an enterprise that is both financially sound and socially aware. What may be considered is an appropriate amendment in paragraph 60 whereby sustainable enterprise development in relation to the various stakeholder groups is exercised under the corporate governance framework.

Principle V

Comments:

We note there is not enough importance or detail on transparency. This is an essential element of a well-functioning system of corporate governance, just the way disclosure is critical to the functioning of an efficient capital market. We know that the global financial crisis has emphasized the importance of transparency and effective risk management particularly in relation to the banking sector. Having said that we agree that improvements in disclosure should result in improvements in transparency which is one of the most important aims of corporate governance reform globally. As per the Cadbury Report (1992):

“The lifeblood of markets is information and barriers to the flow of relevant information represent imperfections in the market…the more of the activities of companies are transparent, the more accurately will their securities be valued”. (Cadbury Report 1992, page 33).

3 This was suggested by PICG earlier in November 2013 at the BIAC-OECD High Level Roundtable, Paris.
Principle VI

Comments:

Agree with the changes suggested. A more rigorous nomination and selection process, along with more open board elections would enable shareholders to exercise their ownership rights in an effective manner. It is pertinent that shareholders are aware and are able to pose questions to the board and put forward proposals to the general meeting of shareholders. Resolutions passed by shareholders should be taken into account by boards. The revised OECD Principles contain recommendations on these points.

There is a typo under Sub-clause (4) - Aligning key executive and board remuneration with the longer term interests of the company and its shareholders, paragraph 112, dthey grant the company to right to withhold and recover compensation from executives in cases of managerial fraud and other circumstances, o the word ôo after the word ôcompanyo should be replaced with ôtheô.