

# THE “NEW” G20/OECD PRINCIPLES OF CORPORATE GOVERNANCE: MORE THAN MEETS THE EYE

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*Simon C.Y. Wong is an independent adviser affiliated with Northwestern University School of Law and London School of Economics and Political Science.*

The OECD Principles of Corporate Governance, adopted by the Financial Stability Board as a key standard for sound financial systems and which have influenced corporate governance regulations and best practice guidelines globally since its issuance in 1999, received a long-awaited update recently.

Last revised in 2004, the new principles have been renamed the G20/OECD Principles of Corporate Governance following an “inclusive” review in which all G20 countries were invited to participate on an equal footing with OECD member countries. Additional input was received from international organizations (such as the Basel Committee, Financial Stability Board, and World Bank), participants of regional OECD corporate governance roundtables, and other stakeholders via a public online consultation.

On the surface – particularly from the perspective of advanced economies such as the United Kingdom – the G20/OECD principles appear to be little more than an overdue catch-up exercise containing few amendments of significance. In its consultation submission to the OECD, the UK National Association of Pension Funds exhorted the Paris-based think tank to “go further and be more ambitious” or risk the revised principles becoming “out of date soon after publication.”

Upon closer inspection, it is apparent that the new principles do feature a number of substantive discussions and changes, including:

- Emphasis on a robust and well-functioning regulatory framework; prominence given
- To proportionality of application;
- Expanded treatment of related party transactions (RPTs);
- Analysis of intermediation in the investment chain, particularly the corporate governance roles of institutional investors and proxy advisors;
- Focus on the board’s role in risk oversight; and
- Expanded definition of materiality

At the same time, the G20/OECD principles give only cursory attention to or omit to address certain topics that have been debated extensively in developed economies, including board diversity (particularly relating to gender), structure of executive remuneration, and “integrated” reporting. Notably, the new principles removed the reference to the concept of “one share, one vote” that was found in the 2004 version.

Perhaps attributable to the extensive involvement of governments in the review, the G20/OECD principles also contain provisions reflecting current global political priorities, for instance, pressing boards to discourage the “pursuit of aggressive tax avoidance.”

Among the most notable features of the G20/OECD principles is the continued emphasis on a robust and well-functioning regulatory framework. In particular, the new principles stress the importance of “operationally independent and accountable” regulatory, supervisory, and enforcement authorities and recommend that any conflicting objectives – for example, a single agency charged with both “attracting business and sanctioning violations” – be avoided. Moreover, the G20/OECD advise governments to scrutinize the role of stock exchanges in setting, supervising, and enforcing corporate governance rules as most are now profit-maximizing enterprises.

In addition, the new principles have inserted “fairness” – alongside transparency and efficiency – as an objective of market regulation. In light of growing fears that the proliferation of trading venues in recent years has created an advantageous playing field for algorithmic traders and left many traditional investors more vulnerable to exploitation, the G20/OECD stress that stock markets “should provide fair and efficient price discovery as a means to help promote effective corporate governance.”

Lastly, although the G20/OECD warn against over-regulation, they urge governments to intervene in situations where “private enforcement” is weak.

In their new incarnation, the principles give considerable prominence to the notion that corporate governance rules and best practices should be applied in a “proportional” manner, particularly as regard to company size. Among the practices that may be more applicable to larger corporations are:

- Disclosure of non-financial information in such areas as business ethics, social issues, human rights, and political donations;
- Establishment of board committees, particularly with respect to audit, risk, and remuneration;
- Investor relations function reporting directly to the board; and
- External facilitation of board evaluation

Recognizing that the continued prevalence of controlling shareholders and corporate groups around the world means that related party transactions (RPTs) will remain commonplace, the new G20/OECD principles provide further guidance on their identification, approval process, and public disclosure.

The G20/OECD recommend that RPTs be defined precisely but broadly and, to ease administrative burden, exclude immaterial transactions and recurring ones that are transacted at verifiable market terms. The new principles also sanction the approval of RPTs by independent board members or disinterested shareholders.

Notably, the principles state that all material RPTs and their terms should be fully disclosed to the market on an individualized basis.

Rather than viewing institutional investors as a homogenous group, the new principles helpfully differentiate the various actors in the investment chains – such as pension funds, insurance companies, and investment managers – and their varied incentives to exercise voting and other governance rights. In particular, the G20/OECD caution that “if shareholder engagement is not part of [an] institution’s business model and investment strategy, mandatory requirements to engage, for example through voting, may be ineffective and lead to a box-ticking approach.” Indeed, this is a problem confronted by many countries.

At the same time, the G20/OECD principles call on institutional investors with active corporate governance policies to disclose how they put them into effect. Relevant evidence in this regard includes actual voting records, staffing levels, and steps taken to minimize institutional obstacles that may impede the effective exercise of their shareholder rights.

Acknowledging the substantial influence of proxy advisors on voting matters, the new principles call for measures to mitigate conflicts of interest or other risks that threaten the integrity of their services. In particular, the G20/OECD expressed concern about proxy advisors offering services to both institutional investor and corporate clients.

Whereas the 2004 principles focused principally on the board’s role in overseeing accounting and financial reporting systems and internal controls, the updated version tasks the board with more expansive risk oversight responsibilities. New areas of focus include ensuring that senior management oversight is in place and compliance programs – which should extend to subsidiaries and, where possible, agents,

distributors, suppliers, joint venture partners, and other relevant third parties – are effective.

Embedded in the Disclosure and Transparency chapter of the OECD principles is a subtle amendment that may ultimately prove to be of great significance. Presently, under most, if not all, securities law regimes, the concept of “materiality” relates only to information that a reasonable investor would consider important in *buying or selling* a security. In the 2015 principles, however, the G20/OECD suggested that information deemed important for making a *voting* decision could also be material. Time will tell whether individual G20/OECD countries and others will embrace this striking idea, although there is little doubt that it will be vigorously debated.

Lastly, it is worth mentioning that the new principles no longer include the following sentences:

“The Principles do not take a position on the concept of ‘one share one vote.’ However, many institutional investors and shareholder associations support this concept.”

Their removal suggests that OECD members favoring “one share, one vote” have abandoned their quest to spread it globally and that there is now broader acceptance of unequal shareholder control rights among G20/OECD member countries.

Although the new G20/OECD Principles of Corporate Governance cannot be described as revolutionary, they helpfully seek to elevate standards in a number of areas relevant to both developed and emerging markets. Moreover, they better reflect the considerable variations in the global corporate governance landscape and acknowledge – if implicitly – the limits of global convergence of corporate governance practices.