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Consultation of the Steering Group with TUAC

Written contribution by the TUAC

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TRADE UNION ADVISORY COMMITTEE
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COMMISSION SYNDICALE CONSULTATIVE
AUPRÈS DE L'ORGANISATION DE COOPÉRATION
ET DE DÉVELOPPEMENT ÉCONOMIQUES

Consultation with the OECD Steering Group on Corporate Governance

TUAC Submission

Paris, 3 November 2009

1. Draft Recommendations on Corporate Governance (DAF/CA/CG(2009)3) are to be discussed and approved by the OECD Steering Group on Corporate Governance on the occasion of its 18th Session, 3-5 November 2009. The Draft Recommendations build on the Committee's previous work on the corporate governance lessons of the crisis and are likely to lay the ground for a forthcoming review of the 2004 Principles of Corporate Governance. TUAC is concerned that the Draft Recommendations suffer from a number of short-comings as regards, process, scope and substance.

2. On process, the Draft Recommendations aim to provide the direction for "a possible future review" of the Principles and hence the terms of reference and objectives of such review process. The current Draft, however, proposes "not to submit" the Recommendations to the Council, but instead to have them endorsed by the Steering Group. TUAC believes that the Council, as the highest body of the OECD, should have responsibility for approving the scope of any review of the Principles. Corporate governance – the system by which private companies are directed and controlled – is a policy and regulatory topic with a significant political dimension. This must not be overlooked and should be reflected in the decision-making processes on the shape of a future review.

- ***It is the highest body of the OECD – the Council – that should discuss and approve the terms of reference of any future review of the Principles.***

3. On scope, the Draft Recommendations are grouped into four sections, corresponding to one or several chapters of the Principles: "Implementation and Enforcement" (Chapter I of the Principles), "Remuneration and Incentives" (Ch. II, V & VI), "Risk Management" (Ch. V & VI), "Board Practices" (Ch. II, V & VI) and "Shareholder Rights" (Ch. II & III). The Draft Recommendations cover all the chapters of the Principles except Chapter IV on the role of stakeholders, in which the Principles address the rights of workers in corporate governance. While collective bargaining and other mechanisms for information, consultation and representation of workers within the firm – works council, board representation – were not part of the problem that led to the current financial and economic crisis, they are, TUAC believes, part of the solution and should be included in any review. Cases of business restructuring, of comprehensive risk management procedures from the shop floor to the board, of corporate short termism are situations where we believe a stakeholder approach to corporate governance can make a difference and should be promoted by the OECD.

- ***The scope of a review of the Principles by the OECD prima facie should not exclude Chapter IV of the Principles on the role of stakeholders in corporate governance. Collective bargaining and other mechanisms that across OECD grant workers with rights to information, consultation or representation in the governance of the firm were not part of the problem that led to the crisis. We believe they are part of the solution.***

4. On substance, TUAC considers the Draft Recommendations to fall far short of what would constitute an adequate policy and regulatory response to the crisis by the OECD. In our previous submission to the Steering Group of April 2009, TUAC warned against a review limited to "amending the already voluminous annotations in the hope that policy makers and the wider public will pick up on the carefully constructed nuances contained therein". Yet, the majority of the 34 recommendations and "emerging good practices" contained in the Draft Recommendations consists largely of re-worded language of the current annotations to the Principles.

5. A prime example of this is the section on the 'rights of shareholders'. Whilst the draft recommendations draw extensively on the existing annotations to the Principles, including on public disclosure of voting records (Recommendations n°27 & 28) and conflicts of interest of proxy advisory services and asset management advisors (n°34), they fail to go much beyond the Principles on these issues, or to address key issues not currently dealt with by the Principles, such as the need to promote long term and responsible investors. In fact, the Draft Recommendations go in the opposite direction by rejecting rules that link voting rights to the length of ownership because of their incompatibility with the principle of equitable treatment of shareholders (n°32). Scepticism is apparent as well in the Draft with regard to rules restricting shareholders acting in concert because of adverse effects on corporate governance-related activism (n°33). In doing so, the Recommendations fail to distinguish between different forms of shareholder activism – those that contribute to the long term interest of the company, and those that do not – and to propose the means by which such distinction could take place. Additionally, there appears to be a reluctance to link corporate governance with socially responsible investment (SRI) principles. This is out of step with current developments in the global financial industry, as illustrated by the high profile of the Principles for Responsible Investment (PRI). The OECD should use the opportunity of the likely review of the Guidelines for Multinational Enterprises to increase linkages with the Principles in any forthcoming review of the latter, notably with regard to the notion of "long term interest of the company".

- ***The OECD should call for regulation to impose mandatory voting disclosure for institutional investors.***

- ***The OECD should promote long term ownership and responsible investment strategies. Forms of shareholder activism should be qualified according to the intended goals and whether the latter serve the long-term interests of the company, or alternatively fuel short-termism.***

- ***The combined use of the Principles and the Guidelines for Multinational Enterprises should be promoted by the OECD and the latter be considered as a benchmark in defining the long term interest of the company.***

6. The Principles also apply to private equity firms and funds, and to hedge funds. Yet the Draft Recommendations do not address the specific corporate governance challenges associated with these private pools of capital: transparency and reporting on risks and on risk management, accountability of the general partners to regulators, to limited partners and to other stakeholders including workers employed by the portfolio companies.

- ***The lack of transparency and accountability of the internal governance structures of private pools of capital – private equity and hedge funds – should be tackled by the OECD.***

7. The Draft Recommendations are similarly disappointing in relation to the organisation of the board of directors. Eight years after Enron, it seems that the OECD has not yet recognised the need to separate the CEO and Chair positions. Annotations to the 2004 Principles say that such separation "may be regarded" as good practice. Recommendation n°18 merely suggests that an explanation be provided if that is not the case. Separation is a prerequisite to ensure that the board can constructively challenge the CEO and top management in the design and implementation of the business plan of the company. On the other hand, the Recommendations do stress the "key role" that the chair of the board (whether or not he/she combines the chair position with the CEO position) should play in tackling "the most important issues", including "risk, strategy, management succession, ethics or relations with shareholders" (n°17). References to "fit and proper" criteria for board membership (n°20-21) and "collective and individual" board membership liability for failure (n°26) are to be welcome. Yet the draft omits addressing the fundamental problem of diversity of boards across OECD which too often are captured by "old boys" networks made up of multiple directorship, if not cross-directorship positions.

- ***The OECD should take a firm and unequivocal position in favour of separating the roles of the CEO and the Chair of the Board in unitary board systems. What is at stake is the Board's capacity to constructively challenge the CEO and top management.***

- ***The OECD should consider the "old boys" networks that still prevail in the Boards across member countries as a serious threat to board accountability. Imposing strict diversity ratios by law (including gender ratios) is part of the solution.***

8. TUAC considers that the Draft Recommendations are also weak as regards board and executive remuneration. Provisions of the 2004 Principles are repeated in recommendations n°7 (alignment with "the longer term interests" of the company and its shareholders), n° 11 (disclosure "in part" on an individual basis), and n°12 (AGM approval of the "policy"). The text does, however, departs from the Principles where it suggests that boards could consider "deferred compensation, claw-backs and adjustment for risk' (n°7), the role of outside consultants (n°8 & 9), the impact of tax systems (n°10). In line with the G20 Leaders' statement at the Summit in Pittsburgh in September 2009, the OECD should endorse similar limits to traders' and bankers' pay in proportion to the size of their firms.

- ***The OECD should call for CEO and top management remuneration to be approved by a third party that is free of conflict of interest: the AGM in unitary board systems, the supervisory board in two-tier systems.***

- ***The OECD call for the alignment of executive remuneration with the long-term interest of the company requires binding regulation on inter alia: an upper ceiling in proportion to the company size and average pay, generalised claw-back provisions and a ban of all performance-related incentives and pension schemes that are not open to the whole workforce of the company.***

9. Regarding risk management, there are few changes compared with the 2004 Principles. The role and "authority" of the risk officer within the company's internal hierarchy

are reasserted (n°14) and suggestion is made that remuneration schemes be factored into the risk management policy (n°16), and the implementation of codes of conducts be properly enforced (n°6). However the Draft Recommendations do not acknowledge the failure of self-regulation in this area. Recent commitments made by the G20 recognise that proper risk-management requires supervisors to be given the necessary tools to intervene in cases of board failure. Indeed in some jurisdictions and sectors, the supervisor agency is empowered to suspend a board decision to distribute bonuses or to remove and replace directors[1].

- ***Self-regulation of corporate governance has failed. The OECD should call for the role and powers of supervisors to be enhanced in disciplining corporate boards.***

10. TUAC is also concerned that the draft text fails to address the role and impact of shareholder remuneration policies that run counter to the interest of the company (and that of long-term shareholders). They should be addressed in any future review of the Principles along with executive and board remuneration.

- ***The OECD should set principles for shareholder remuneration policies – dividends and share buy-back programmes – to be aligned with the long-term interest of the company and be taken into account in the companies' risk management policy.***

[1] Furthermore, a forthcoming study by the OECD Economics Department suggests that among existing forms of prudential rules, "exit and disciplining rules" have played a significant role in mitigating the impact of the current crisis on banks' equity valuation alongside the "strength of supervisor" and "entry/ownership rules", all of which bear significant corporate governance dimensions and compare very favourably with other forms of prudential regulation (capital requirements, accounting, liquidity provisions, etc.). See: "Prudential Regulation and Competition in the Banking and Insurance", 24 September 2009, ECO/CPE/WP1(2009)15 .