TRADE UNION ADVISORY COMMITTEE
TO THE ORGANISATION FOR ECONOMIC
COOPERATION AND DEVELOPMENT
COMMISSION SYNDICALE CONSULTATIVE
AUPRÈS DE L'ORGANISATION DE COOPÉRATION
ET DE DÉVELOPPEMENT ÉCONOMIQUES

Consultation with the OECD Committee on Corporate Governance, 17 March 2014

TUAC Submission on the Review of the Principles

Paris, 10 March 2014

1. The TUAC welcomes the opportunity to share comments on the upcoming review process of the OECD Principles of Corporate Governance ("the Principles"). The current Principles, which date back to 2004, cover the key areas of corporate governance in a comprehensive manner. But the Principles could be considerably improved in light of the policy lessons and challenges drawn by the OECD itself following the 2008 financial crisis and the prolonged economic and social crisis that has hit our economies since then. We dispute the suggestion that the Principles have "stood the test of time" and therefore that a limited review is appropriate. In what follows, we outline what we believe should be the core priorities of the review process in order to strengthen the Principles.

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Scope and ambition of the review

2. The OECD Secretariat "Issues note"[1] on the review process – circulated 24 February – captures a number of global policy challenges which were drawn from previous work conducted by the Committee on corporate governance, including:

- The severe *shortcomings in the boardroom* and in the responsibility of shareholders to exercise stewardship as identified in the "Conclusions and emerging good practices" adopted by the Committee in 2010 in light of the 2008 financial crisis;

[1] Review of the OECD Principles of Corporate Governance: Issues Note, 24-Feb-2014 - DAF/CA/CG(2014)2

15, rue La Pérouse - 75016 Paris - France
Tel: +33 (0)1 55 37 37 37 - Fax: +33 (0)1 47 54 98 28 - tuac@tuac.org - www.tuac.org

- The *changing nature of ownership structure* and of *trading patterns* (rise of private exchanges and trading through "dark pools" and of high frequency trading); and

- The increasing *complexity and lengthening of the investment chain* linking the ultimate shareowners (including pension funds) and invested companies.

3. The above policy challenges are relevant in helping set the policy context to the upcoming review. However the process would be strengthened by examining the broader policy lessons and root causes of the crisis which are drawn by the OECD as part of its on-going initiative for "New Approaches to Economic Challenges"[2], including:

- The *under-pricing of risk* in the financial sector, including equity and credit markets, that created "the wrong incentives and led to insufficient and ineffective regulatory and risk management frameworks" could be addressed in the upcoming review by requiring stronger principles on board responsibility and on accountability along the investment chain;

- *Rising inequality* across OECD and the G20 economies, and the need to shift toward more inclusive approaches that combine "social equilibrium" with "economic equilibrium" would have some bearing in the discussion on executive compensation, the long term interest of the company and the role of key stakeholders;

- The *undesirable effects of pro-growth policies* that have generated "negative externalities" on societies, and the *evolving nature of global value chains*, including the role of knowledge-based capital, could be addressed as well in the Principles by enhancing risk management policy and reporting in order to cover environmental, social as well as tax-related issues.

4. The private corporation is an essential engine of growth and of wealth creation of our economies. But it needs to be governed appropriately and held to account for its impact and contribution to economic prosperity. There is no single way or blueprint to achieve this and indeed there is "no one size fits all." National corporate governance regimes vary around the world. Yet, the OECD lessons from the global crisis suggest that much could be done to improve the OECD Principles in providing broad guidance to policymakers, regulators, investors and companies.

TUAC priorities

5. For that to happen, the revised Principles should become aspirational and aim at the highest standards of governance to achieve the long term interest of the company and broader sustainability objectives. The current text however gives the impression of a lowest common denominator between all jurisdictions. And yet it ignores, or unnecessarily tones down, many common features of OECD regimes such as two-tier board structures, worker representation and

[2] New Approaches to Economic Challenges - A Framework Paper, Meeting of the OECD Council at Ministerial level, 23-24 May 2012 http://www.oecd.org/general/50452415.pdf

the governance implications of having controlling shareholders. The review should be both aspirational and comprehensive enough to account for the diversity of national regimes.

6. For TUAC and its affiliates, the review of the OECD Principles of Corporate Governance should aim for the following:

Workers' voice	• Recognising workers' right to information, consultation, representation and negotiation based on the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights; • Protecting workers' creditor claims; and • Promoting sustainability & tax reporting.
Investment chain	• Ensuring transparency and accountability of asset managers and other intermediaries to asset owners and address conflicts of interests; and • Reducing the reliance on performance-related pay.
Shareholder rights	• Securing shareholders' right to hold boards accountable ; • Promoting responsible use of shareholder rights to help curb short-termist market behaviour; and • Recommending mergers and takeovers rules to be subject to the long- term interest of the company.
Board organisation & duties	• Setting principles for board diversity (gender, minorities and employee representation); • Enhancing the duties of directors and risk management to account for the growing complexity of businesses and their responsibility vis-a-vis all stakeholders; and • Adopting separation of CEO and chair functions as a principle.
Executive pay	• Reining in executive pay to rebuild confidence and trust in executive management, including through reducing the reliance on performance-related pay, and designing remuneration packages in line with the long- term interest of the firm; and • Ensuring disclosure of individual pay and CEO/worker ratio, and approval by shareholders and independent directors.

Raising the voice of workers in the firm

7. When asked what is the most "valuable asset" of the firm, CEOs invariably respond: their staff and employees. Workers' firm-specific investments are an essential source of corporate wealth creation through human capital development and intangible assets. Workers, as employees of the firm, however are equally exposed to firm-specific risk, including market and production risks but also occupational and health and safety risk. Workers can also be exposed as creditors of the firm. That is particularly true in the case of bankruptcy and other severe restructuring processes when workers' entitlements to severance pay, to pension and/or healthcare are tied to the solvency of firm. It is in the long-term interest of the firm to ensure that workers' voices are heard and their views made known on the business plan of the firm.

8. Various mechanisms exist across OECD and G20 economies to ensure workers' voices in the governance of the firm. These rights are recognised and upheld by several ILO conventions,

and by the OECD Guidelines for Multinational Enterprises (MNE). The most fundamental form of contractual governance consists of collective bargaining between senior management and worker representatives, including at MNE-level "international framework agreements". But other important mechanisms to participate in company decision-making also exist such as works councils and board-level employee representation.

9. The current text poorly reflects on the role of workers as employees and their contribution to the long term success of the firm: laws and "mutual agreements" should be "respected" (Principle IV.A), stakeholders should have a right to redress (IV.B) and access to information (IV.D), whistle-blowers should be protected (IV.E), "performance-enhancing mechanisms" for employee participation should be "permitted" to develop (IV.C), corporate reporting should include "issues regarding employees and other stakeholders" (V.A.7) and boards should apply high ethical standards and "take into account the interests of stakeholders" (VI.C).

TUAC proposals

10. It is in the long term interest of the firm to allow workers, as employees and sometime as creditors of the firm, to be informed and consulted on and make their views known on (i) the long term strategy of the company, (ii) the foreseeable risk factors, and – where appropriate – on (iii) any business restructuring that may affect their working conditions and pay. Accordingly the review should aim at:

Worker representation	• Recognise a right for workers as employees to information, consultation, representation and negotiation through collective bargaining (and international framework agreements) and various governance mechanisms including works councils and board-level employee representation;
Workers' creditor claims	• In case of bankruptcy, set as a best practice workers' creditor claims over the firm (unpaid wages, severance, unemployment, pension, other benefits) to have senior status and precedence over other creditors;
Defining stakeholders	• Define the scope for stakeholders to align with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights; and
ESG & tax reporting	• Enhance corporate reporting and risk management to include reporting on environmental, social and governance (ESG) and country-by-country tax reporting.

Accountability along the investment chain

11. The lengthening of the investment chain between asset owners and investee companies is interfering with the ability to ensuring transparency and accountability in the effective exercise of shareholder rights. Asset managers and other intermediaries in the investment chain ought to be accountable to asset owners and to regulators for all decisions that affect beneficiaries including

the effective exercise of shareholder rights. The current text however refers to "institutional investors" at large and does not distinguish between asset owners and managers (II.F[3] and II.F.1[4]).

12. It would be especially important to highlight the pivotal role of asset managers and other intermediaries in the investment chain including the duty to act in the interests of the ultimate beneficiaries and exercise voting rights effectively, the prevention of conflict of interest and of overreliance on short-term trading strategies. The current text of the Principles does address these issues, in part, but they could be substantially reinforced (III A.3[5], II.F.2[6] and V.F[7]). The OECD text is, however, silent on the design and transparency of remuneration of asset managers and other mechanisms that encourage long termism such as increasing voting rights for long-term owners. High levels of asset manager remuneration necessarily reduce the investment returns of asset owners. For this reason, asset management fee levels and associated investment costs should be reasonable and fully disclosed to asset owners. Tying the remuneration of asset managers to "pay-for-performance" criteria, even if long-term, can create perverse incentives. Any performance criteria can be gamed.

TUAC proposals

13. Considering the increasing lengthening and complexity of the investment chain between ultimate owners of shares and invested companies, the review should aim at:

Asset management accountability to asset owner	• Adding a new Principle on the accountability of asset managers to asset owners and the interests of ultimate beneficiaries relying in long-term investment returns; • Enforce mandatory public disclosure of the exercise of voting rights by asset managers;
Transparency and design of asset management remuneration	• Ensure full transparency of the remuneration of asset managers and other intermediaries; • Reduce reliance on pay-for-performance criteria – fixed remuneration with a limited number, or no performance-related elements, would be more effective in terms of encouraging behaviour conducive to long-term investment performance; and
Integrity along the investment chain	• Underline the need for clear prevention of conflicts of interest by asset managers and other intervening advisors in the investment chain.

[3] II.F "The exercise of ownership rights by all shareholders, including institutional investors, should be facilitated"

[4] II.F.1 "Institutional investors acting in a fiduciary capacity should disclose their overall corporate governance and voting policies"

[5] III A.3 "Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares"

[6] II.F.2 "Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments"

[7] V.F. on ensuring "the provision of analysis or advice by analysts, brokers, rating agencies and others, that is relevant to decisions by investors, free from material conflicts of interest"

Responsible use of shareholder rights

14. Ensuring shareholders are empowered to exercise effective and responsible stewardship of the firm should be a central concern of the review especially in relation to the current text on the "effective shareholder participation in key corporate governance decisions" (II.C), such as the right to nominate and remove directors, and to vote on executive remuneration. Engagement between shareholders and directors should go both ways: directors should be willing to communicate directly with shareholders when appropriate and especially in response to corporate governance failures. The presence of mechanisms that enhance control can help stabilise and promote long term approaches to shareholder stewardship of the firm. Mechanisms that enhance control, such as dual class system of shares, should not, however, entrench company founders.

15. Shareholders should be able to act collectively (II.G) as long as there is sufficient transparency of share ownership structure and beneficial ownership (V.A.3). Some forms of shareholder activism seek quick returns on the back of the company's long-term sustainability such as "rampant takeovers" by activist hedge funds and applying pressure to obtain extraordinary dividends and "share buyback" programmes. Between 2003 and 2012, 449 companies in the S&P 500 Index spent 54% of their earnings in share buybacks, amounting to $2.4trillion, in addition to 37% as dividends. Little was retained for productive reinvestment. The need for companies to adequately reinvest retained earnings to sustain economic growth and their future profitability deserves attention in the OECD text.

16. In the context of takeovers, the decision-making process is too often guided exclusively by price per share, and hence by short-term considerations, and not by the long term potential growth of the company and accordingly this should be addressed in relevant Principles (II.E[8] & II.E.1[9]).

17. The OECD text does not reflect on the responsible forms of shareholder activism which have gained traction in recent years, as seen in the rising number of sustainability-related resolutions presented at annual general meetings of shareholders, and in new international norms and guidance related to responsible business conduct. For asset owners with long term horizons, environmental, social and governance issues have become paramount. Under the UN Guiding Principles on Business and Human Rights – which form the basis for the revised OECD Guidelines for Multinational Enterprises – shareholders can be "linked" to an adverse impact on human rights caused by the company whose shares they own, and accordingly are expected to apply due diligence and to engage with company management.

TUAC proposals

18. Shareholders have rights but also responsibilities. Facilitating shareholder activism is desirable as long as it is framed within responsible business conduct principles and is compatible with the long-term interest of the firm. In light of that:

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[8] II.E. "Markets for corporate control should be allowed to function in an efficient and transparent manner"

[9] II.E.1 "The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse"

Securing shareholders' right to hold boards to account	• Shareholders should have meaningful rights to hold the board accountable including removing directors through majority voting in director elections, and having a binding vote on the remuneration policy and practice of the board.
Facilitating responsible shareholder behaviour	• Shareholders have a responsibility to exercise due diligence over the company's respect for international norms and standards as outlined in the UN Guiding Principles on Business and Human Rights. • Shareholder activism should allow companies to adequately reinvest their retained earnings and implement their stakeholder responsibilities adequately.
Mergers and takeovers to subject to a long term interest test	• Rules governing changes in the ownership structure and mergers and takeovers should prioritise the long-term interest of the company (including requiring takeover panels to adopt a "long-term interest test"), address conflicts of interest and ensure full transparency of beneficial ownership.

Reinforcing board accountability

19. Despite efforts to promote board diversity, "old boy" networks based on multiple and interlocked directorships and "imperial CEOs" too often still prevail in boardrooms. This alone constitutes a serious threat to board accountability and to the capacity of the board to constructively challenge the CEO and the executive management. Diversity and independence are needed to ensure that the board is accountable to key constituencies of the firms – shareholders, regulators, workers, creditors, and local communities among others. A stand-alone principle on board diversity (of gender, of minorities, of professional backgrounds) would support accountability and relevant Principles should reflect that (VI.E[10] & VI.E.1[11]).

20. Board-level employee representation is common practice across OECD economies. The fact that not every national corporate governance regime has it should not prevent the Principles from addressing it. The OECD Guidelines on Corporate Governance of State-Owned Enterprises has a stand-alone Guideline on employee representation[12] which could form the basis for a corresponding new Principle. Board independence is, rightly, defined in the OECD text as independence vis-à-vis executive management, not the company as whole, and where appropriate vis-à-vis controlling shareholders. This definition needs to be reasserted, to ensure that board level employee representatives are not excluded from the list of independent directors.

21. The growing complexity of corporate business activities and risk management, as seen in the rise of the global value chain system affecting both small and large business groups, also calls for an adjustment of the definition of both directors' duties and risk management systems. At a minimum the review should aim to identify the core sources of risk – economic, and financial, but also social, environmental, tax-related – to which the firm and its stakeholders may be exposed.

[10] VI.E "The board should be able to exercise objective independent judgement on corporate affairs"

[11] VI.E.1 "Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest"

[12] SOE VI.D "If employee representation on the board is mandated, mechanisms should be developed to guarantee that this representation is exercised effectively and contributes to the enhancement of the board skills, information and independence."

Risks can be located within the legal perimeter of the firm but also beyond and down the supply chain, as outlined in the UN Guiding Principles on Business and Human Right and the OECD Guidelines for Multinational Enterprises. This could be reflected in the Principles on directors' duties (VI.A) and on risk management and compliance with the law and relevant standards (VI.D.7).

TUAC proposals

22. Diversity and independence are needed to ensure that accountability of the board to key constituencies of the firms – shareholders, regulators, workers, creditors, and local communities among others – is upheld. The growing complexity of corporate business activities and risk management also calls for an adjustment of the definition of both directors' duties and risk management systems. Considering the above:

Separation of CEO and chair functions	• Separation of chair and CEO positions should be required and, under two-tier structures, former CEOs should not be allowed to become chair of the supervisory board.
Promoting board diversity	• Rules governing board organisation should restrict multiple directorships, meet diversity criteria – including gender and minorities – and independence criteria so as to constructively challenge the CEO and executive management. • Board-level employee representation should be recognised as a mechanism that contributes to both board diversity and independence.
Enhancing the duties of directors and risk management	• The responsibility of directors for the company's key stakeholders and company reputation should be reflected in the legal duties of directors. • The board responsibility to manage risk should be spelled out to account for the growing complexity of corporate activities and structures, both within and beyond the legal perimeter of the firm, including social, environmental and tax risk and in line with international norms such as the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises.

Reining in executive pay

23. Despite the global financial crisis and the many CEO pay scandals that have occurred since, board and executive remuneration practices have not changed. In the US, the CEO-to-worker pay ratio has increased from 42:1 in 1982 to 281:1 in 2002, and to 354:1 in 2012. Similar trends are observed in Europe. Such levels of executive pay fuel rising inequality and pose a serious threat to workers' and citizens' trust in the role of the private corporation in society. High pay disparities within companies hurt employee morale and productivity. When combined with poorly structured incentive targets high executive pay leads to excessive risk taking.

24. The current OECD text could be considerably strengthened to help rein in executive pay, be it with regard to board responsibility to fix remuneration (VI.D.4[13]), the role of independent

[13] VI.D.4 "The board should fulfil certain key functions, including: (…) Aligning key executive and board remuneration with the longer term interests of the company and its shareholders"

directors (VI.E.1[14]), shareholders' right to "say on pay" (II.C.3[15]) and disclosure (V.A.4[16]). Shareholders' right to "say on pay" should become a stand-alone Principle. Performance-related pay is a major part of the problem in terms of excessive executive remuneration. Many of the proposals for linking pay more strongly to long-term company performance can be counter-productive in terms of the impact on the scale of executive remuneration, as directors tend to discount future pay and pay that is subject to uncertainty[17].

TUAC Proposals

25. Moderating executive pay levels, including reducing the gap or ratio between the pay of rank-and-file employees and directors and making them contingent on the long term sustainability of companies will help ensure that executives are not tempted to make bad business decisions. The review should aim at the following changes:

Designing remuneration packages in line with the long term interest of the firm	• The design of executive remuneration should include rigorous claw-backs;, severance pay should be strictly aligned with those provided to employees of the company; performance-related elements should be a much lower proportion of total pay; and asymmetric forms of compensation such as stock options should be discouraged;
Disclosure of individual pay and CEO/worker ratio	• Mandatory disclosure of all elements of individual executive remuneration packages and of ratios of CEO to worker pay should be recommended;
Role of shareholders and independent directors	• Board processes for setting and designing executive remuneration packages should be led by non-executive independent board members • Shareholders should have a right to a binding vote on directors' pay.

[14] VI.E.1 "Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are (...) board remuneration"

[15] II.C.3 "Shareholders should be able to make their views known on the remuneration policy for board members and key executives. The equity component of compensation schemes for board members and employees should be subject to shareholder approval".

[16] V.A.4 "Disclosure should include, but not be limited to, material information on: (…) Remuneration policy for members of the board and key executives (…)"

[17] "Making executive pay work - A global study into the impact of pay and incentives on senior executives", PwC, 2012 www.pwc.com/hrs