



Consultation with the OECD Committee on Corporate Governance, 13 October 2014

TUAC Submission on the Review of the Principles of Corporate Governance

Paris, 10 October 2014

Meeting on 13-14 October 2014, the OECD Committee on Corporate Governance is to consider a second proposal of revision of the Principles of Corporate Governance. Ahead of a consultation with the Committee 13 October morning, the TUAC submits the following comments and proposals of amendments on the OECD draft.

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Overview

The proposed marked-up (document DAF/CA/CG(2014)3/REV1) offers a number of improvements to the text. For example, Chapter I (Supervision & enforcement) includes two new Principles respectively on the regulation of private exchanges (I.D) and on fair pricing in trade venues (I.G) which, as we understand it, aim at addressing the concerns around unregulated “dark pools” markets and speculative high frequency trading.

In light of our initial statement on the review process in March¹ and our marked-up proposal that followed in April², we believe however that more could be done to raise the ambition of the review process as a whole. In previous submissions, the TUAC outlined five priorities for the review process: (i) Raising the voice of workers in the firm, (ii) Accountability along the investment chain, (iii) Responsible use of shareholder rights, (iv) Reinforcing board accountability, and (v) Reining in executive pay.

In what follows, we share our comments and suggested amendments to the text chapter-by-chapter, based on the above priorities. Among others, our marked-up proposals aim at:

- Encouraging a responsible use of shareholder rights and disclosure of shareholders’ responsible investment practices (Ch. II & III);
- Accountability of asset managers and other financial intermediaries (Ch. III);

¹ 10/03/2014| TUAC Submission on the Review of the Principles of Corporate Governance
http://www.tuac.org/en/public/e-docs/00/00/0E/49/document_doc.phtml

² 30/04/2014| TUAC Marked-Up Proposals of the OECD Principles of Corporate Governance
http://www.tuac.org/en/public/e-docs/00/00/0E/76/document_doc.phtml

- Recognising that stakeholders (other than shareholders) have rights and setting as a principle the right of workers of the company to be informed and consulted (Ch. IV);
- Ensuring robust company reporting on non-financial risks, including human rights, social, environmental and tax risk (Ch. V); and
- Highlighting board oversight of executive remuneration, of risk management and of compliance with international agreements, the need for separation of CEO and chair position in one-tier board structure and the equal treatment of board-level employee representatives (Ch. VI).

Regarding process and policy coherence within the OECD:

- We urge the Committee to raise the public visibility of the process and to give instructions to the OECD Secretariat for stakeholder groups – including responsible investment forums and relevant NGOs – to make their voice heard; and
- We hope that relevant OECD bodies – including those covering responsible business conduct, institutional investor long term investment practices, corporate taxation, and green growth – are also engaged appropriately in the process.

Marked-up proposals

In order to distinguish between the OECD marked-up proposals and the TUAC proposals, the following extracts of the Principles show (i) OECD proposals highlighted normally (underlined or ~~strikethrough~~) and (ii) TUAC proposals highlighted in **green / grey** (underlined or ~~strikethrough~~)

Chapter II: The Rights and Equitable Treatment of Shareholders and Key Ownership Functions

We welcome the revision of the chapter where it lumps existing and new texts on related-party transactions in a new series of Principles (II.H, II.H.1 & II.H.2) and where it integrates principles on protection of minority shareholders which were previously located in chapter III. In line with our previous submissions – including our call for “responsible use of shareholder rights” and “reining in executive pay” – we believe that the draft could be further improved with regard to:

- Recognising that shareholders should use their rights in a responsible manner (Title and header of the chapter);
- Strengthening the wording on shareholders’ right to vote on executive remuneration – respecting to that end the difference between one-tier and two-tier board structures (II.C.3); and
- Referencing the long term interest of the company and the rights of stakeholders (other than shareholders) in setting the rules for mergers and takeovers (II.D.1).

TUAC marked-up proposal of Chapter II:

II. THE RIGHTS, RESPONSIBILITIES AND EQUITABLE TREATMENT OF SHAREHOLDERS AND KEY OWNERSHIP FUNCTIONS

ANNOTATIONS: (...). **Shareholder rights should be exercised in a responsible way. Shareholder practices taking account of the long term interest of the company, including its capacity to invest and the resilience of its balance sheet, and its social and environmental performance and impact should be facilitated. Shareholders are expected to exercise due diligence over the company regarding observance of international norms and standards as outlined in the UN Guiding Principles on Business and Human Rights.**

II.C.3 Effective shareholder participation in key corporate governance decisions, such as the nomination and election of board members, should be **secured facilitated**. Shareholders should be able to make their views known, **including through votes at annual shareholder meetings**, on the remuneration policy and packages **for board members, and** for key executives **in one-tier board systems**. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.

II.D.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**. Transactions should occur at transparent prices and under fair conditions **that take into account the long term interest of the companies involved and** protect the rights of all shareholders according to their class **and the rights of other affected stakeholders**.

Chapter III: Institutional Investors, Stock Markets, and Other Intermediaries

The creation of a new chapter III on institutional investors, stock markets and other intermediaries is a real step forward. It helps bring attention to the challenges associated with the lengthening of the investment chain between asset owners and the investee companies. Based on our previous submissions, including our call for ensuring “Accountability along the investment chain”, we propose amendments in relation to:

- The accountability of investors and of financial intermediaries (Title of the chapter and III.B);
- The disclosure of responsible investment practices alongside corporate governance and voting policies (III.A); and
- The upgrading of the proposed OECD text on the transparency of asset managers’ fee structure, from annotation to principle-level text (III.C).

TUAC marked-up proposal of Chapter III:

III. ACCOUNTABILITY OF INSTITUTIONAL INVESTORS, AND OF STOCK MARKETS, AND OTHER INTERMEDIARIES

III.A Institutional ~~investors~~ **owners** acting in a fiduciary capacity should disclose their corporate governance and voting policies with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights. **Where an institution has a declared policy to vote, disclosure of actual voting records is considered good practice. They should also disclose any responsible investment practice.**

III.B **Votes should be cast by** Custodians or nominees **should cast votes** ~~in a manner agreed upon~~ **line** with **the directions of** the beneficial owner of the shares **and should be held accountable to that end.**

III.C 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. **The fee structure of asset management services should be transparent throughout the investment chain.**

Chapter IV: Role of Stakeholders

The revised text offers minor, but noticeable improvements to the annotations, including: annotations to IV.A (due diligence procedures are to be considered as “best practice” for ensuring compliance with internationally recognised standards) and to IV.C (reference to “international conventions recognising workers’ right to information, consultation and negotiation”).

Considerably more could be done in reviewing this Chapter however to rebalance, in the Principles as a whole, the rights of shareholders with those of other stakeholders – while at the same time respecting the diversity of governance models across the OECD and beyond. Considering our past submissions – including our call for “raising the voice of workers” – our suggested changes to the text aim at:

- Recognising that stakeholders have rights (Title of the chapter);
- Upgrading reference to due diligence procedures, from annotation to principle-level text in IV.A;
- Highlighting the need for rule of law and for efficient and accessible judiciary systems in IV.B;
- Eliminating reference in principle IV.C to “performance-enhancing mechanisms” (terms which are not used in practice) and replacing it with a reference to mechanisms for information and consultation rights, as suggested already in the annotations; and
- Protecting the right of workers’ creditor claim in case of bankruptcy and group restructuring (IV.F).

TUAC marked-up proposal of Chapter IV:

IV. THE **ROLE RIGHTS** OF STAKEHOLDERS ~~IN CORPORATE GOVERNANCE~~

IV.A **The company should ensure compliance with the rights of stakeholders that are established by law** ~~or, through mutual agreements or by internationally recognised agreements are to be respected, including through due diligence procedures.~~

IV.B ~~Where stakeholder interests are protected by law,~~ Stakeholders should have the opportunity to obtain effective redress for violation of their rights.

ANNOTATIONS: The legal framework and process should be transparent and ~~not impede the ability~~ **secure the right** of stakeholders to communicate and to obtain redress for the violation of rights **including through rule of law and access to efficient and independent judiciary system.**

IV.C **Mechanisms should be in place for employees and their representatives to be represented, informed and consulted about the business plan and foreseeable risk factors and to negotiate with management in case of substantial change in working conditions and pay and in case of restructuring process.** ~~Performance-enhancing mechanisms for employee participation should be encourage to develop.~~

IV.F (...) ANNOTATIONS: (...) **Workers’ creditor claims over the firm (unpaid wages, severance, unemployment, pension, other benefits) should have senior status and precedence over other creditors than tax collectors.**

Chapter V: Disclosure and Transparency

The proposed amendment to Principle V.A.3 requiring disclosure of beneficial ownership is very welcome. We also note proposed changes to the annotations to V.A.1 (mentioning country-by-country reporting as a requirement “in some countries”), to V.A.2 (encouraging reporting on human rights within the supply chain, considering transparency of political donations as a “good practice” and making reference to sustainability and “integrated” reporting) and to V.A.8 (reporting on collective bargaining coverage and of mechanisms for employee representation “may be included”).

While these changes are welcome, their wording and placement in the text could be reconsidered in order to raise the aspiration of the Chapter as a whole. Also, the revised draft does not offer any real improvement on other issues, most notably regarding CEO and executive remuneration. Moving further, and considering our call for “raising the voice of

workers in the firm” and for “reinforcing board accountability”, we suggest the following amendments aiming at:

- Ensuring robust reporting on non-financial risks and impacts in Principles V.A.2, V.A.7 & V.B; and
- Ensuring transparency over individual remuneration of executives and board members, as well as of the pay ratio of the CEO to the average employee in V.A.4.

TUAC marked-up proposal of Chapter V:

V.A.2 Disclosure should include, but not be limited to, material information on: (...) **Company objectives and non-financial information, including sustainability reporting.**

ANNOTATIONS: In order to provide a comprehensive assessment of the company's performance and exposure to risk, in addition to their commercial objectives, companies are encouraged to should disclose policies, performance and impacts relating to business ethics, the environment, tax payments, human rights within their supply chain, and other public policy commitments. Such information may be important for investors and other users of information to better evaluate the relationship between companies and the communities in which they operate and the steps that companies have taken to implement their objectives. In many countries, such disclosures are required for large companies, typically as part of their management reports. Many companies have started to embrace concepts such as sustainability or “integrated” reporting.

V.A.4 Disclosure should include, but not be limited to, material information on: (...) **Individual remuneration policy for of members of the board and key executives, including the pay ratio of the CEO to the average employee.**

V.A.7 Disclosure should include, but not be limited to, material information on (...) **Foreseeable risk factors, including human rights, labour, environmental and tax-related risks, and measures taken to manage such risks.**

V.B. Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure reporting.

The application of high quality standards is expected to significantly improve the ability of investors to monitor the company by providing increased reliability and comparability of reporting, and improved insight into company performance. ~~The quality of information substantially depends on the standards under which it is compiled and disclosed. The Principles support the development of high quality~~ Most countries mandate the use of internationally recognised standards for financial reporting, which can serve to improve transparency and the comparability of financial statements and other financial reporting between countries. Such standards should be developed through open, independent, and public processes involving the private sector and other interested parties such as professional associations and independent experts. High quality domestic standards can be achieved by making them consistent with one of the internationally recognised accounting standards. In many countries, listed companies are required to use these standards. For reporting on corporate governance and other non-financial issues, established global reporting standards such as the Global Reporting Initiative's Guidelines provide a useful reference.

Chapter VI: Responsibilities of the board

We welcome the proposed new principle VI.G on board-level employee representatives, the text of which is partly drawn from the OECD Guidelines on state-owned enterprises (SOEs). The proposal of revision also offers improved annotations to:

- VI.A (duties) and VI.C (ethics) where it reads respectively that board members' duty of care “does not oblige” to pursue aggressive tax planning strategies and that board oversight of management tax planning strategy is seen “increasingly”;
- VI.D.4 (board & executive remuneration) in which claw back provisions are considered “good practice”;
- VI.D.7 (financial reporting & risk management) calling for compliance policy to extend to “relevant international agreements, such as those covering securities, competition, taxation, human rights and work and safety conditions”; and

- VI.E.4 (board evaluation) including an OECD recommendation to set “voluntary targets, disclosure requirements and private initiatives that enhance gender diversity on boards and in senior management of listed companies”;

In line with our previous submissions regarding the need to reinforce board accountability, we suggest further amendments to the text with regard to:

- A general expectation to undertake due diligence regarding stakeholders’ rights in (VI.C);
- The need for greater board discipline – beyond claw-back provisions – in setting executive remuneration packages (VI.D.4);
- The upgrading of the text on international agreements, from annotation to principle-level text in VI.D.7;
- The role of board composition – separation of CEO and Chair positions, board diversity – in ensuring objective and independent judgement over corporate affairs (VI.E); and
- The rights of board-level employee representatives to be considered equal to those of other board members (if indeed they ought to have the same “duties and responsibilities”) in Principle VI.G, and the assumption that employee representation should not *in itself* be considered as a threat to board independence (in line with the OECD Guidelines on SOEs, but also with the recommendations of the US SEC³ and of the European Commission⁴).

TUAC marked-up proposal of Chapter VI:

VI.C The board should apply high ethical standards. It should take into account the interests of stakeholders and undertake due diligence in order to avoid infringing on stakeholders’ rights.

ANNOTATIONS: add reference to the United Nations Guiding Principles for Business and Human Rights.

VI.D.4 The board should fulfil certain key functions, including (...) Aligning Ensuring key executive and board remuneration does not lead to excessive pay disparity within the company or to excessive management risk taking behaviour and is aligned with the longer term interests of the company and its shareholders stakeholders.

ANNOTATIONS: (...) While remuneration should be designed to help attract qualified professionals, boards should be concerned with the risk and consequences for setting excessive remuneration levels. High pay disparities within companies hurt employee morale and productivity and bear significant reputational risks. When combined with poorly structured incentive targets high executive pay leads can lead to excessive risk taking. (...)

³ US Securities and exchange commission - Standards relating to listed company’s audit committee (as of April 25, 2003), Point II.F.3.a.i "We understand that some countries, such as Germany, require that non-management employees, who would not be viewed as "independent" under the requirements, serve on the supervisory board or audit committee. *Having such employees serve on the board or audit committee can provide an independent check on management, which itself is one of the purposes of the independence requirements under the Sarbanes-Oxley Act.* Accordingly, we are adopting as proposed a limited exemption from the independence requirements to address this concern, so long as the employees are not executive officers, as defined by Exchange Act Rule 3b-7. [...] Under the final rule, non-executive employees can sit on the audit committee of a foreign private issuer if the employee is elected or named to the board of directors or audit committee of the foreign private issuer pursuant to the issuer's governing law or documents, an employee collective bargaining or similar agreement or other home country legal or listing requirements". <http://www.sec.gov/rules/final/33-8220.htm>

⁴ Commission Recommendation 2005/162/EC of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board. Annex II, §1 "It is not possible to list comprehensively all threats to directors’ independence [...]Such criteria, which should be tailored to the national context, should be based on due consideration of at least the following situations: [...] (b) not to be an employee of the company or an associated company, and not having been in such a position for the previous three years, *except when the non-executive or supervisory director does not belong to senior management and has been elected to the (supervisory) board in the context of a system of workers’ representation recognised by law and providing for adequate protection against abusive dismissal and other forms of unfair treatment;*"

VI.D.7 The board should fulfil certain key functions, including: (...) **Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant international agreements and standards. Large companies should put in place an internal audit function and an audit committee of the board to oversee the effectiveness and integrity of the internal control system.**

ANNOTATIONS: (...) Moreover, compliance must also relate to other laws and regulations, as well as relevant international agreements, such as those covering securities, competition, taxation, human rights, and work and safety conditions. Such compliance programmes will also underpin the company's ethical code. To be effective, the incentive structure of the business needs to be aligned with its ethical and professional standards so that adherence to these values is rewarded and breaches of law are met with dissuasive consequences or penalties. Compliance programmes should also extend where possible to subsidiaries and where possible to third parties, such as agents and other intermediaries, consultants, representatives, distributors, contractors and suppliers, consortia, and joint venture partners. Under the United Nations Guiding Principles for Business and Human Rights and the OECD Guidelines for Multinational Enterprises, all companies are required to respect human rights, which means that they undertake human rights due diligence in order to avoid infringing on the human rights of others.

VI.E The board should be able to exercise objective independent judgement on corporate affairs. This should be reflected in the composition of the Board including through separation of CEO and chair positions and diversity of gender, of skills and of geographic origins.

ANNOTATIONS: (...) In a number of countries with single tier board systems, the objectivity of the board and its independence from management may be is strengthened by the separation of the role of chief executive and chairman Chair, or, if these roles are combined, by designating a lead non-executive director to convene or chair sessions of the outside directors. Separation of the two posts may be is generally regarded as good practice, as it can helps to achieve an appropriate balance of power, increase accountability and improve the board's capacity for decision making independent of management. The designation of a lead director is also regarded as a good practice alternative in some jurisdictions if that role is defined with sufficient authority to lead the board in cases where management has clear conflicts. Such mechanisms can also help to ensure high quality governance of the enterprise and the effective functioning of the board.

The Chairman or lead director may, in some countries, be supported by a company secretary. In the case of two tier board systems, consideration should be given to whether corporate governance concerns might arise if there is a tradition for the head of the lower board becoming should not be able to become the Chairman of the Supervisory Board on retirement. (...)

VI.G When 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.

ANNOTATIONS: When employee representation on boards is mandated by the law or collective agreements, it should be applied so that it contributes to the boards' independence, competence and information. Employee representatives should have the same duties, rights and responsibilities as all other board members, should act in the best interests of the company and treat all shareholders stakeholders equitably. Employee representation on boards should not in itself be considered as a threat to board independence. (...)

Opening up the process, ensuring policy coherence

To our knowledge, since the launch of the review, other than the regular BIAC/TUAC consultations, the OECD Secretariat has held only one stakeholder consultation – on 16 March 2014 with a selected number of experts. No summary report of that meeting has since been shared. The OECD webpage on the review process⁵ does not offer further information neither, although it is understood – but yet to be confirmed – that a public consultation would be held in December based on a draft proposal of revision posted on the OECD website.

For TUAC, raising the visibility of the review process outside the OECD walls is essential. On 25 June 2014, we held a half-day roundtable on the review of the Principles at the OECD, with the participation of several OECD delegations, the BIAC, the UN Office of the High Commissioner on Human Rights and the Institute for Human Rights and Business. Reports

⁵ <http://www.oecd.org/daf/ca/2014-review-oecd-corporate-governance-principles.htm>

and video recordings are posted on our website⁶. We also keep our network of trade union pension fund trustees informed via the Global Unions Committee on Workers' Capital⁷.

We urge the Committee to raise the public visibility of the process and to give appropriate instructions to the OECD Secretariat for stakeholder groups – including responsible investment forums and relevant NGOs – to make their voice heard in the review process. On that, we note and we support the letter from the Global Reporting Initiative (outlining a proposal of amendments to V.A.2 & V.B) which is tabled as a room document (ref DAF/CA/CG/RD(2014)3).

Corporate governance touches upon the very heart of the private corporation: its licence to operate in society. Because of that, it cannot be dealt with in isolation. Corporate governance is both influenced and influencing other corporate-related policy areas – labour law and securities market regulation, but also a number of key rising policy issues within the Organisation: responsible business conduct, institutional investors long term investment practices, corporate taxation, and green growth. We hope that the relevant OECD bodies have been and will be engaged appropriately in the review process.

On that, we note that the OECD Working Party on Responsible Business Conduct, also meeting on 13 October, is to address a background note looking precisely at the policy coherence between the Principles of Corporate Governance and the Guidelines for Multinational Enterprises (“Strengthening the Link Between Corporate Governance and Responsible Business Conduct”, DAF/INV/RBC(2014)3). The content of this note is, in our view, very encouraging and we would hope that it will be circulated and addressed by the Committee as well.

⁶ http://www.tuac.org/en/public/e-docs/00/00/0E/F6/document_doc.phtml

⁷ www.workerscapital.org