Institute for
Human Rights and Business
Shaping Policy ▪ Advancing Practice ▪ Strengthening Accountability

ROUNDTABLE ON THE REVIEW OF THE PRINCIPLES OF CORPORATE GOVERNANCE & THE GUIDELINES ON THE CORPORATE GOVERNANCE OF STATE OWNED ENTERPRISES

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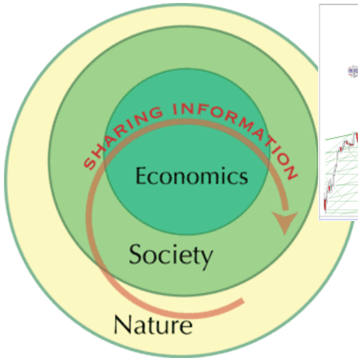
MARGARET WACHENFELD, DIRECTOR OF RESEARCH & LEGAL AFFAIRS

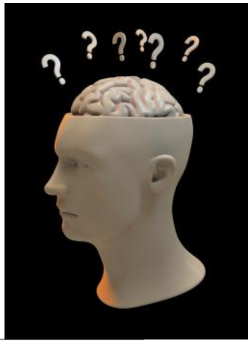
Corporate Governance for the 21st Century

What does 21st Century Corporate Governance Look Like?

- Or: What has changed in the 10 years since the 2004 update of the Corporate Governance Principles that should be reflected in the 2015 update?
- A lot…



Corporate Governance for the 21st Century



Rethinking who is the governance actually for?

- Questioning the supremacy of the Maximising Shareholder Value (MSV) ideology
  - Is the corporation being governed only to maximise value to shareholders or is there an evolving wider view of the role of companies that should be conveyed in new rules for the 21st century?
  - Recent Challenges coming from many different directions to MSV, to idea that is is all about the shareholders because current model leads to:
    - short-termism of reporting, shareholder interest in long-term value of the company (where does high velocity trading fit in this shareholder model),
    - declining innovation in search for shorter profits, senior management without commitment, race to the bottom on employment conditions, aggressive tax planning
  - Push back from companies (refusing to prepare quarterly reports), company leaders (Branson's B Team initiative)…. And OECD & G7
- Instead: Corporate Governance Principles for the 21st Century should →
  - reflect an approach of managing companies for the longer-term with a focus on sustainable value for companies, society and the environment

Privatisation of Profits and Socialisation of Costs – Is that Corporate Governance for the 21st Century?

- **Short-termism created "Increased systemic risks.** *The combination of MSV with limited liability leads to systemic moral hazard. The shareholders of corporations benefit from the short term value created by inconsiderate risk taking while being shielded from the medium/long term losses for the corporation and for society that may come from this kind of inconsiderate risk taking:* ***"privatization of profits and socialization of costs"***

- *"In China and elsewhere, political and regulatory threats to 'business as usual' are rising. Privatisation of profits and socialization of costs is increasingly unacceptable to the public…In the future, such state intervention is likely to broaden in scope and deepen in nature… Corporates out to act pre-emptively to mitigate these risks and long-term investors ought to encourage and demand they do so."* (Financial Times, Financial Markets Section, 24 June 2013, "Green bookkeeping shows real business costs)

- Profits? Yes! **But …** taking account of the true costs imposed on the environment & society through:
  - Regulation: Polluter Pays Principle, etc.
  - Accounting, especially on the environmental side but starting to see accounting for social capital ….**Natural Capital at Risk: The Top 100 Externalities of Business**, **White paper: Natural and social capital accounting in the apparel sector**
  - International standards
  - Multistakeholder initiatives

Corporate Governance for the 21st Century

Standards for the 21st Century that focus on people … who is economic development for?

Point One: Vision

- Start with a vision of Corporate Governance for the 21st Century
  - Consider the broader vision of what corporate governance *should* look like –
    - Seems to be agreement between both BIAC and TUAC on the general principles that good corporate governance should support the building of sustainable value in organisations and society
      - So this is an important starting point

- Start with a vision of corporate governance for *all*
  - Globalised world where SMEs are the lifeblood
  - Principles on Corporate Governance should be for *all* - think of the message it sends to say that smaller companies don't have to worry about appropriate governance

    Strong support for BIAC's position on this

Point Two: Process

- Have a pubic consultation & widen the consultation beyond corporate governance experts to get a wider view of corporate governance beyond "the usual suspects"

  - Include human rights organisations, organisations working on reshaping the financial sector, think about Principles for Responsible Investment (PRI) Initiative, organisations working on visioning a more sustainable society

Point Three: Policy Coherence

- Integrating relevant OECD initiatives into the revision
  - Seemingly obvious point of integrating "your" own work into Principles on Corporate Governance
    - OECD Guidelines on Multinational Enterprises
    - Assuming there will be some coherence with Guidelines on Corporate Governance of SOEs
    - Action Plan on Base Erosion and Profit Shifting (BEPS) – is there something from this work that would be appropriate to cross-reference?

- Referencing other relevant standards that OECD consistently refers to
  - like international human rights standards, ILO Core Labour Standards, UN Guiding Principles on Business & Human Rights

- Another point of policy coherence: some might argue that it is too much of a stretch to expect this of all companies
    - But OECD recently carried out a Myanmar Investment Policy Review
    - 1st chapter was on Responsible Business Conduct with a robust set of recommendations
    - If can expect responsible business conduct from the Government and companies in Myanmar, where else in the world would it *not* be appropriate to make the same demands?

Point Four: Rights & Responsibilities

- Broader point throughout the revised Corporate Governance Principles of balancing of rights and responsibilities of all parties:
  - Company
  - Board
  - Shareholders
  - Stakeholders
- Policy coherence point: for shareholders, consider the work going on with respect to the OECD Guidelines and their application to the financial sector, including to investors
  - This would be an appropriate place to look for guidance on what responsibilities for shareholders look like

Point Five: Strengthening the Focus on Stakeholders in the Corporate Governance Principles

There are already evidence of a shift in models in the OECD of giving more weight to the consideration of stakeholders:

- **Shareholder Approach** → director's actions aimed at maximising shareholder value
- **Stakeholder Approach** → directors are required to take a range of stakeholders beyond shareholders into account
  - Netherlands – directors must act in the interest of the company in the broadest sense, combined interest of shareholders, employees, creditors and even society at large
- **Enlightened Shareholder Value Approach** → hybrid
  - UK Companies Act where Directors must have regard to employees, impact on the community & environment

Background Research on the linkages between Corporate Governance & Human Rights

- Conclusion from a 2010 Study conducted for the UN SRSG on Business & Human Rights - survey of corporate and securities law in 39 jurisdictions

- **Corporate and securities law does intersect with human rights**

"Simply put, ***where the impact on human right may harm a company's short- or long-term interests if it is not adequately identified, managed and reported,*** *companies and their directors and officers* ***may risk non-compliance with a variety of rules promoting corporate governance, risk management and market safeguards****. Even where the company itself is not at risk, several States recognise through their corporate and securities laws that* ***responsible corporate practice should avoid negative social or environmental consequences, including for human rights****."*

Background Research on the linkages between Corporate Governance & Human Rights

General Trends identified in the UN SRSG's research on corporate and securities law:

1. Directors are **generally permitted to consider impacts on non-shareholders**, including human rights impacts provided they are acting in the company's best interests
   - Morever, in a growing number of jurisdictions, directors are **explicitly or implicitly required to consider such impacts** at an oversight level in order to act with the expected care & due diligence, especially where failing to do so might expose the company to reputation, legal or other risk
2. **Prudent director would do well to consider** and act on potential human rights impacts, in accordance with their oversight role
3. Increasing **need for directors to balance company's short-term and long-term interests** in considering impacts on non-shareholders

Human Rights as an Important and Legitimate Consideration in Risk Management

Variety of different influences lead to the conclusion that human rights risks are increasingly seen as legitimate consideration in risk management:

- New legislation
- Law suits – civil and criminal
- Reputational damage
- Securities listing requirements
- Pressure from investors
- Reporting requirements ….
  - See new EU Directive on Disclosure of Non-financial And Diversity Information By Certain Large Companies And Groups 2014
  - *"Shall include in the consolidated management report a consolidated non-financial statement containing information ….. performance and position and of the impact of its activity, relating to, as a minimum , environmental,* ***social and employee matters, respect for human rights****, anti-corruption and bribery matters:"*
    - Reporting on: Policy, outcome, principle risks (including with business relationships), KPIs

Point Five: Human Rights & Directors / Board Duties

Recommendation:

- The Corporate Governance Principles should include a reference to both the OECD Guidelines on Multinational Enterprises & the UN Guiding Principles on Business & Human Rights
  - As core part of ethical standards applied by Board
    - To be applied by the company to figure out what human rights risks it may cause, contribute or be directly linked to and & how they should be managed
  - And make supervision of the management of these risks the responsibility of a Board member, together with the other kinds of risks identified in the OECD Guidelines on Multinational Enterprises

Point Six: Support for Other Human Rights Cross-References

- Diversity on Boards
  - A call for diversity reflects and important reinforcement of the basic human rights message of non-discrimination
  - BIAC and TUAC are both supporting inclusion of points on board diversity in the Corporate Governance Principles
  - EU Non-Financial Disclosure Directive – will requiring disclosure of polices and approaches on board diversity

- Labour Rights
  - Strengthening of principles on worker representation

Point Seven: Support for Strengthening other Corporate Governance Principles

Support for strengthening principles within the Corporate Governance Principles:

Accountability

- Basic principle of human rights – strengthened accountability
- Strengthen focus on effective governance

Transparency

- Theme that comes through strongly from many different areas
- Support increasing disclosure on key risks and how they are managed, including human rights

Economic Justice – developing principles for an appropriate approach to

- Remuneration – principles that reward the creation of sustainable value, aligned with a focus on the long-term and transparent