Understanding the draft revisions to the G20/OECD Principles of Corporate Governance

49th Digital Reporting Workshop

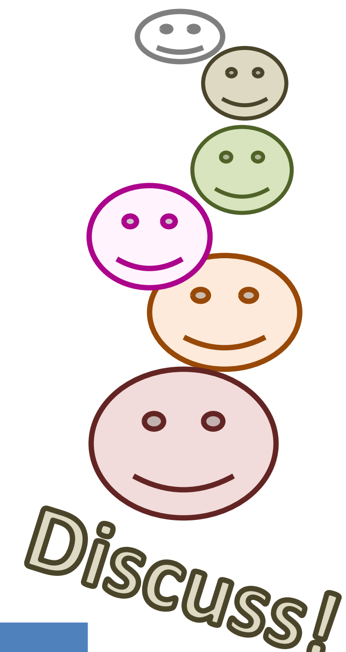
Date and time : 20th Jan 2023, 20:00-21:30 JST

G20/OECD Principles of Corporate Governance: a new chapter on sustainability and resilience

We have been discussing disclosure related issues since 2014, mostly investors and market participants in Japan and inviting foreign friends. Discussion themes are chosen from IFRS or Corporate Governance issues and responding public consultation of IASB or other organisations. Since we responded EU consultation Fitness Check in 2018, we have recently picked up the Sustainable / environment topics as agenda.

The G20/OECD Principles of Corporate Governance are being revised and the process will be finalised this year. Many Asian countries are following the Principles.
https://www.oecd.org/corporate/review-oecd-g20-principles-corporate-governance.htm

In this workshop, we were able to understand the review taking place since 2021, and the background that motivated the revisions. We also heard opinions from investors and the impact it may have on Asian countries. And we discussed what should be done to continue improving corporate governance.



	Who join the discussion?
Attendees (Japan) *attendees have joined this workshop as private,	12 Asset Managers, 6 Investor(Analysts) organisation, 2 sell-side analyst, 2 pension & insurance & bank, 8 Information providers/Researchers, 6 Company side (include Independent non - executive director, support service), 6 Auditor, 2 academic 6 Regulator & Accounting setter & stock exchange, 1 other
Attendees (outside Japan)	3 Asset Managers, 1 pension & insurance & bank, 1 Information providers/Researchers, 1 academic, 1 other

Review of the G20/OECD Principles of Corporate Governance

About This Principle and The Review, From OECD Home Page

https://www.oecd.org/corporate/review-oecd-g20-principles-corporate-governance.htm

OECD

The OECD Corporate Governance Committee is reviewing the G20/OECD Principles of Corporate Governance. The review was launched in November 2021 and will be completed in 2023. OECD, G20 and FSB members participate in the review as well as other countries through the Committee's regional Roundtables (Asia, Latin America and the Middle East and North Africa).

The overall objective of the review is to update the Principles in light of recent evolutions in capital markets and corporate governance policies and practices. The Corporate Governance Committee identified a range of priority areas to take into consideration during the review, including the management of environmental, social and governance risks; digitalisation; corporate ownership and concentration; and institutional investors and stewardship, among others. An important overarching goal of the revision is to support corporate sector resilience and to improve companies' access to finance from capital markets.

In October 2021, OECD Ministers and G20 Leaders supported the Committee's decision to review the Principles. Ministers and Leaders "recognised the importance of good corporate governance frameworks and well-functioning capital markets to support the recovery, and looked forward to the review of the G20/OECD Principles of Corporate Governance".

The Corporate Governance Committee conducted a public consultation on draft revisions to the Principles from 19 September to 21 October 2022. All contributions can be found **here**.

Priority areas and supporting publications

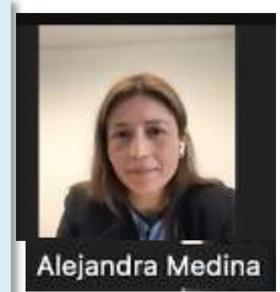
The Terms of Reference for the review identified 10 priority areas. To inform the Committee's discussions on these priority areas, a number of reports and working papers were prepared and released publicly concomitantly with the public consultation:

- Climate change and corporate governance
- Corporate ownership and concentration
- Gender diversity on company boards and in senior management
- The role of board-level committees in corporate governance
- Digitalisation and corporate governance
- Institutional investors and stewardship
- The role and rights of debtholders in corporate governance

More about the review

Sustainability and resilience: the new chapter in the Principles

- The G20/OECD Principles of Corporate Governance were first issued in 1999. The Principles support regional regulators and currently have **six pillars.** (1) Effective corporate governance framework, (2) Shareholder equity, (3) Institutional investors, capital markets and intermediates, (4) role of stakeholders, (5) Corporate disclosure, (6) Directors' responsibilities. The Principles has been adopted in 53 jurisdictions.
- **The strategic priorities of the Principles are** (1) to promote access to finance, innovation and entrepreneurship; (2) to provide a framework to protect investors; and (3) to support corporate sector sustainability and resilience
- The big change is **the draft revision is a new chapter on Sustainability and Resilience**. This is linked to 1. Disclosure, 2. Shareholder Rights, 3. Role of Stakeholders, and 4. Responsibilities of Directors. It promotes financial and non-financial disclosure and the use of high-quality international standards that facilitates comparability. It also recommends that verifiable metrics are included so that investors can assess progress towards their goals and targets. The new chapter also recommends directors to consider assurance and engage in dialogue with shareholders about important corporate decisions regarding sustainability. It is important that all stakeholders are involved and the sustainability matters achievement would be useful for the evaluation the directors' remuneration and nomination.



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New chapter: Sustainability and resilience (I)

- **Sustainability disclosure**: Promote the disclosure of financial and non-financial information and the use of high-quality international standards that facilitate comparability. Guidance on the concept of materiality.
  - ***VI.A***. *Sustainability disclosure should be consistent, comparable and reliable, and include retrospective and forward-looking material information that* ***a reasonable investor*** *would consider important in making an investment or voting decision.*

    VI.A.1. *Sustainability information should be considered* ***material if it can reasonably be expected to influence an investor's assessment of a company's value***. *[…], such assessments may also consider sustainability matters that are critical to a company's key stakeholders or a company's influence on non-diversifiable risks.*

    VI.A.2. *Sustainability disclosure frameworks should be consistent with high quality, understandable, enforceable and* ***internationally accepted core standards*** *that facilitate the comparability of sustainability disclosure across markets.*

    […]

    VI.A.4. *If a company publicly sets a sustainability-related goal or target, the disclosure framework should ensure that* ***verifiable metrics are disclosed*** *to allow investors to assess the credibility and progress toward meeting the announced goal or target.*

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New chapter: Sustainability and resilience (II)

- **Sustainability disclosure (cont'd.)**: Recommend the external assurance of sustainability disclosure in the long-term.
  - ***VI.A.5***. *Phasing in of requirements should be considered for* ***annual assurance attestations*** *by an independent, competent and qualified assurance service provider in accordance with high quality international assurance standards in order to provide an external and objective assessment of a company's sustainability disclosure.*
- **Shareholders and stakeholders**: Promote dialogue in companies' important decisions on sustainability.
  - ***VI.B.*** *Corporate governance frameworks should allow for the* ***dialogue between directors, key executives, shareholders and stakeholders*** *to exchange views on sustainability matters as relevant for the company's business strategy and its assessment of what matters ought to be considered material.*
- **Board responsibilities**: Clarify that material sustainability risks and opportunities must be considered by the board, and highlight the importance of the "business judgement rule" for long-term investments.
  - ***VI.C. Boards should ensure that governance practices, strategy and risk management policies adequately consider material sustainability risks and opportunities****, including climate-related physical and transition risks.*
  - ***V.A.1.*** *Board members should be protected against litigation if a decision was made in good faith with due diligence.*

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Issue of company groups in Asia

■ Across jurisdiction is hard to find a definition of what is a company group. The draft revised Principles **encouraged jurisdictions to have a relevant definition for company groups**. The draft revisions also call for increasing disclosure on the capital structure, group structures and control arrangements. Second, the revisions also seek to improve risk management by ensuring disclosure on large or complex risks related to company groups and by ensuring board members' access to key information about group activities. The revisions also seek to improve disclosure of related party transactions by better identifying all related parties in complex group structures and addressing potential conflicts of interest.

■ The revisions also recognize the increasing use of **stewardship codes by institutional investors**. They also reflect the increasing use of ESG indices, data and ratings by institutional investors and their rise as indirect engagement tools for institutional investors. Through increased disclosure, the Principles aim **to minimize conflicts of interest for proxy advisors, ESG ratings and index providers**.

■ The revisions also differentiate the mandatory establishment of the **audit committee** while the nomination and remuneration committees are established on a "comply or explain" basis. They recognise the increasing role of risk, technology or sustainability committees, and they clearly emphasise flexibility in the establishment of committees.

■ The revisions fully consider all **diversity criteria**. They also recognise gender diversity enhancement through disclosure requirements, quotas and targets, but also through additional and complementary measures to strengthen the female talent pipeline and reinforce other diversity policy measures.

■ On **risk management**, board's oversight should comprise company-relevant risks, including health crises, supply chain disruptions and geopolitical tensions, as well as digital security risks and tax risks.

Proposed revisions: Company groups

- Promote a **clear regulatory framework** for company groups and improve the disclosure of capital structures, group structures and their control arrangements.
  - *I.H (Annotation) […] jurisdictions are encouraged to develop a definition and criteria for the oversight of company groups focusing on aspects such as the controlling relationship of group companies and their parent, companies' domicile, and eligibility to join financial consolidation, among other aspects.*
  - *IV.A.3. The disclosure of capital structures, group structures and their control arrangements should be required.*
- Improve **risk management** by ensuring boards' access to key information.
  - *V.F. (Annotation) […] In cases when a publicly traded company is a part of a group, the regulatory framework should also ensure board members' access to key information about the activities of its subsidiaries to manage group-wide risks and implement group-wide objectives.[…]*
- Improve disclosure of **related party transactions** by better identifying all related parties in complex group structures and addressing potential conflicts of interest.
  - *IV.A. Financial and non-financial disclosure should include, but not be limited to, material information on:*

    7. Related party transactions.

    (Annotation) […] Special consideration should be given to whether the corporate governance framework properly identifies all related parties in jurisdictions with complex group structures involving publicly traded companies.[…]

Digital and role of the bondholders

OECD

- The growing use of **digital technologies** and the related opportunities and risks, and the need to take into account these evolutions both in supervisory practices as well as regulatory frameworks. Companies must also adapt to rapid changes. One of them has been **remote AGM**. Regulators in many jurisdictions have changed laws to allow it. It is necessary to verify the safety of these data and systems. However, remote participation should not decrease the possibility for shareholders to engage with and ask questions to management in comparison to physical meetings.The draft revisions address the importance of a technology-neutral approach and the need to facilitate remote participation in AGMs in an appropriate manner.

- In some jurisdictions, there has been an increasing need to address the rights and influence **of bondholders**. Since listed companies are important issuers of corporate bonds, we need to consider the role and rights of bond holders in corporate governance. The proposed revisions seek to facilitate the exercise of bondholders' rights and also promote the timely disclosure of material information about debt contracts, including the risk of breaching covenants to help investors understand business risks.

Proposed revisions: Digital technologies

- Strengthen corporate governance practices and supervision with digital technologies while addressing related risks. Underline the importance of a **technology neutral approach**.
  - ➢ ***I.F.** Digital technologies may be used to enhance the supervision and implementation of corporate governance requirements, but also require that supervisory and regulatory authorities give due attention to the management of associated risks.*
- Promote **virtual or hybrid shareholder meetings** with proper conduct.
  - ➢ ***II.C.3.** General shareholder meetings in virtual or hybrid format should be allowed as a means to facilitate and reduce the costs to shareholders of participation and engagement. Such meetings should be conducted in a way to ensure equal access to information and opportunities for participation of all shareholders, regardless of whether physical or virtual.*
- Ensure board responsibilities for **digital security risks** in terms of disclosure and risk management.
  - ➢ ***V.D.2.** (Annotation) […] Of notable importance is the management of digital security risks, which are dynamic and can change rapidly. Risks may relate, among other matters, to data security and privacy, handling of cloud solutions, authentication methods, and security safeguards for remote personnel working on external networks. As with other risks, these risks should be integrated more broadly within the overall cyclical company risk management framework.[…]*

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Proposed revisions: Corporate debt and bondholders

- Address the increasing importance of **corporate debt and bondholders** in markets, their rights, and their impacts.
  - ➢ ***VI.D.6.** The exercise of the rights of bondholders of publicly traded companies should be facilitated.*

    (Annotation)The extended and substantial rise in the use of bond financing by publicly traded companies and their subsidiaries warrants greater attention to the role and rights of bondholders in corporate governance. […]
- Promote **disclosure of material information on debt contracts**, including the risk of non-compliance with covenants.
  - ➢ ***IV.A.** Financial and non-financial disclosure should include, but not be limited to, material information on:*

    ***IV.A.10.** Debt contracts, including the risk of non-compliance with covenants.*

    (Annotation)[…] the timely disclosure of material information on debt contracts, including the impact of the most significant risks related to a covenant breach and the likelihood of their occurrence, is necessary for investors to understand a company's business risks.

Questions & opinions from investors

I have a question about virtual meetings. Hybrid is recommended in terms of access to AGMs, but is virtual only AGMs also recommended?

ESG Analyst
Japan

This was a controversial point. At first, we assumed hybrid and virtual were the same. However, investors complained about fully virtual AGMs arguing they were not heard by management. Hybrid meetings allow investors to attend in person. The problem of virtual AGM is the concern that management may only pick questions they want to answer. Having that in mind, hybrid may be a preferred option. However, many jurisdictions argued that in fully virtual meetings are working well. We may end up focussing on protecting the rights of shareholders despite the format of the meeting.

Thank you very much. I think the last part is very important. In Germany, for example, the law was changed to clarify only the virtual-only conditions. It is important to ensure that shareholders have access to information and tools.

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I think activists always think that virtual is more problematic than a hybrid. Because companies can not only cherry-pick questions, but they can also silence them. So activists will always be against full virtual AGMs. However, as a small shareholder like myself, virtual meetings are fine as long as opinions are taken up in the same way as other larger shareholders.

Mike Lubrano
Investor in US

It has been pointed out that very large multi-national companies, such as Google and Amazon, operate across multiple countries and are not necessarily aware of the corporate governance codes of specific countries.
For example, although it is often said, there seems to be some doubts about whether these companies are paying taxes properly in the countries where they operate. Was there any discussion about that?

Governance
Expert Japan

The Principles do not mention in particular multi-national companies, but they do refer to the OECD Guidelines for Multinational Enterprises. However, the problems with multinational companies are similar to those of company groups. Different countries have different definitions and we may need clear definitions. There are cases where there are many layers of subsidiaries. Regulators in each jurisdiction should aim for transparency with respect to the these groups structures. In the midst of tax and money laundering issues, we need to focus on what the G20/OECD Principles of Corporate Governance can do.

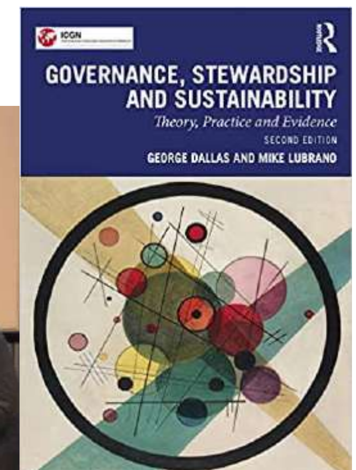
Investor opinion for this revision

Mike Lubrano
Investor in US

- As an investor in emerging markets from the United States, this revision will be welcomed in the corporate governance of emerging markets. This revision reflects the recognition that this pattern is far from universal. The OECD is now advocating for jurisdictions to develop a definition of what constitutes a Company Group. But it may prove practical even within a single jurisdiction for there to be different definitions of Company Group for different purposes – for example, there are different rules today around consolidation for different purposes.
- One thing I commend the OECD for in this revision is the inclusion of specific references to bondholders. I have an issue with where the bondholder discussion is included in the current draft of the revision. The problem is that bondholders are recognised as Other Stakeholders in the sustainability chapter. This is not the right place for them. Bondholders are financial investors in the company, with many interests that are akin to those of equity investors. In capital, market bond holders need the same information as shareholders. Information provided by credit analysts is also shared with the equity market.

←OECD Roundtable
Mike 2nd from right

ICGN event in Nov.→
Introduction the publication of the governance book



Investor opinion for this revision.   cont.

Mike Lubrano
Investor in US

- Another thing I would like to highlight about the revision is the treatment of assurance of sustainability data. I am very happy that this was picked up as an area for future development. This requires regulatory- and market-driven practices, just as it did with financial statements. It is important to understand that current processes around the securing of assurance of sustainability data do not parallel those of assurance of financial information. Today's financial audit process involves direct communication between the auditors and the Board or Audit Committee, and the auditor's report is addressed to them and is submitted to investors. Today's practices around E and S assurance are not like that. Sometimes it's done by a provider, and the board isn't involved. So, as a next step, I would like to see the OECD step forward to address how the Board should be involved, for example, in selecting providers and so on. This is information for investors. That information needs to be more accurate. Proper assurance by a third party is important. But equally important is the benefits the Board itself gets from the assurance process. The process can get the Board to carry on valuable discussions around what are the company's material sustainability issues. This is the same as we now discuss audited financial statements with the Audit Committee. I think this will be additional practice for non-financial information. Also important is the process of selecting the assurance provider, the scope and level of assurance sought, and the degree of assurance (limited vs. reasonable).

- Another highlight is that the OECD Principles mention stewardship for the first time. When the Principles were first conceived, there was a view that if shareholders were secure in their rights, they would use them, improving the governance of investee companies. The concept of stewardship recognises that there also need to be standards, codes, expectations and best practices around how investors play their part in governance, hence the proliferation of stewardship codes in recent years. The revised code also makes clear the difference between investor stewardship and ESG.

- Finally, the revised Principles use the terms sustainability and resilience. Resilience refers to the ability to cope with unexpected shocks and developments. But the value of this distinction is not entirely clear to me. Investors will be discussing this with the Board, so it would be nice if the OECD could better explain the difference between the two.

OECD efforts to improve corporate governance over 20 years

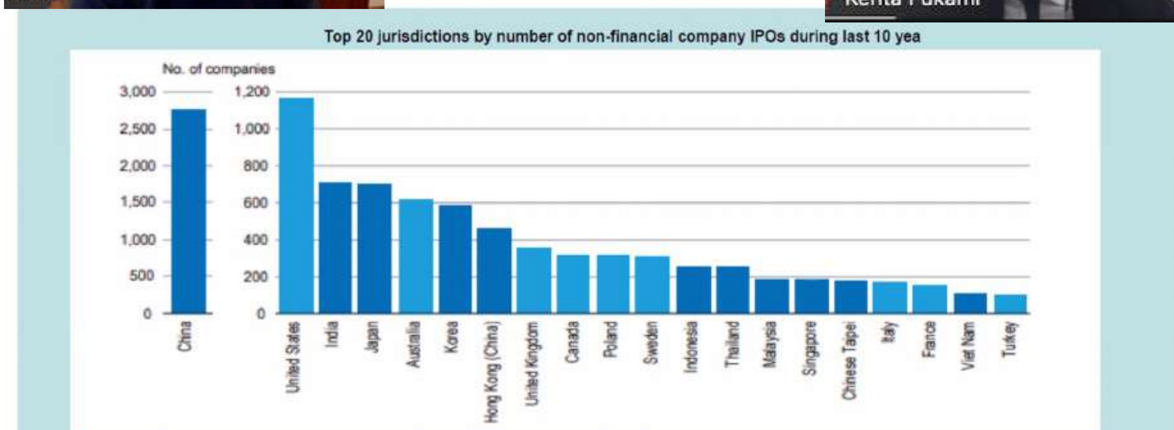
About the background of the OECD's activities on the policy of corporate governance. In the 1990s, the equity market grew in Asia, rapidly expanding its role in the global market. In 2009-12, it accounted for 50% of global IPOs. By 2021, half of the world's listed companies are in Asia.

This OECD Principle is widely accepted in Asia. For example, in 2015, Japan introduced the CG code for the first time, and the OECD supported the FSA in developing the code. The OECD Principles have helped many countries reform their corporate governance.

One of the reasons why this principle was accepted by many countries is because of its flexibility. The OECD recognises that there is no single model for corporate governance and the principles are applicable to any practical board structure. Secondly, this principle was evidence-based development. Whenever the OECD sends its recommendations, it is carefully aligned with the data. And we have presented tailored recommendations according to the situation of each country.

Finally, the OECD offers special programs for Asian countries. Every year, OECD holds a roundtable discussions with a wide range of stakeholders, from regulators to academics, and explains why the principle is important.

Sustainability disclosure standards are currently being discussed, but without the “G” part, I think that E and S alone are useless, no matter how good they are. Accountability is required for how materiality was determined and what the assurance is. Therefore, I think it is extremely timely that the OECD governance principles have been revised to include sustainability disclosure and responsibility at this time.
And indeed, the OECD supports regulators of financial supervision around the world.



Source: OECD "OECD Corporate Governance Factbook 2021"

Importance of Assurance for Sustainability disclosure

Mike commented that this revision covered assurance, but I don't think that it would be the same as auditing the financial statements. The process that Mike mentioned about how assurance is provided, the interactions and judgement of board members will be an important issue. There are many assumptions in the assurance of non-financial information process compared to assurance of non-financial information.

The Principles are targeted at public companies. Therefore, when they refer to bondholders, they the bondholders of bonds issued by listed companies. The main concern is how to protect bondholders and provide information related to bond contracts to shareholders.

Whether the Principles apply to bondholders in general, this is up to each regulator to decide.

There are many countries in Asia that are striving to become more attractive to investors. Some of them are using scorecards to measure progress on their corporate governance practices. The Principles provide a global standard benchmark on how regulators should respond to such countries.

The current code requires management to take responsibility for the quality of financial statements. Therefore, once the code covers sustainable information, management will also be responsible for the quality of those information. Is that what the important part of this draft?

Management is responsible for the financial statements, and the board must oversee them and see their audit quality. I agree that non-financial assurance cannot be done in the same way as financial audits.
However, this is an example in the US, there is a real estate company that disclosed emissions calculated based on power consumption. It can be calculated by specifying the power source. This should be auditable. Of course, I also agree with the need for forward-looking information.

The board should be responsible for all information disclosed by the company in the first place. Regardless of assurance or other information. However important information is often missing from company disclosures. Because some companies are concerned about the accuracy of the information and refrain from disclosing it. we have to think about these issues

ESG research Japan

Opinions came from attendees (after workshop)

"I agree with Alejandra's comment that assurance to financial statements and assurance to non-financial statements are completely different. Assurance to financial statements is an assurance to the past. It is to prove the fact that happened was true. By contrast, assurance to non-financial is an assurance to the future. It is to prove the entity's future behaviour will stay good. In theory, proving the future is impossible. However, there might be means to bring it closer. That is corporate governance.

Having said that, I don't think only corporate governance works for assurance. I think an internal control system is the key. In my view, internal control is the essence of corporate governance. Even we follow every single item of the corporate governance code, if the entity did not have an effective internal control system, it would not work. Therefore I think the challenge for sustainability disclosure is the challenge for a better internal control system. We have to make further effort to improve internal control mechanism."

He is absolutely right. Indeed, we are emphasising in the new draft the role of internal auditors and also the 2015 Principles highlight the importance of internal control systems and processes for the proper functioning of the company. In the draft revisions, Pple. V.E.2. also highlights *"… the importance of specialised committees to support the full board in performing its functions, in particularly in respect to the audit committee – or equivalent body – for overseeing disclosure,* ***internal controls****……"*

I second Alejandra's comments. One of the great accomplishments of the OECD Principles is to define CG as much more than simply the role and responsibility of the Board of Directors. The Principles have stressed the entire internal and external governance ecosystem from the start. The internal control environment is an essential part of the governance of every company, without which the system as a whole fails. I would take a bit of issue with the statement that assurance of non-financial information around sustainability is always in the future. While sustainability itself is by definition is a future-focused concept, important E&S information in sustainability reports and integrated reports (such as carbon emissions, water usage, and employee attrition) is historical. Companies disclose patterns in historical E&S indicators to provide an indication of the future, which is subjective. But the past data should be reliable, and assurance is a valuable thing to have.

We should continue to discuss this!