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3 January 2015

OECD Corporate Governance Committee
Directorate for Financial and Enterprise Affairs
Corporate Affairs
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Dear OECD Corporate Governance Committee

OECD Principles of Corporate Governance: Draft for Public Comment — November 2014

Governance Institute of Australia (Governance Institute) is the only independent professional association in Australia with a sole focus on the practice of governance. We provide the best education and support for practising chartered secretaries, governance advisers and risk managers to drive responsible performance in their organisations.

Our members have primary responsibility in listed companies to deal with the Australian Securities Exchange (ASX) and interpret and implement the listing rules. Our Members deal on a day-to-day basis with ASX and have a thorough working knowledge of the operations of the markets, the needs of investors and the listing rules, as well as compliance with the Australian Corporations Act (the Act). Our members also hold primary responsibility within listed companies for developing governance policies and supporting the board on all governance matters.

Governance Institute is a founding member of and ongoing contributor to the ASX Corporate Governance Council, which develops and issues Australia's governance code, the *Corporate Governance Principles and Recommendations*, now in its 3rd edition.

We welcome the opportunity to comment on the 2014 revised OECD *Principles of Corporate Governance* (the OECD Principles).

General comments

Governance Institute supports the OECD Principles' role in providing an enabling environment for policy makers across the globe to implement corporate governance frameworks. We also recognise that the OECD is particularly keen to address governance issues in emerging economies and related party transactions in the 2014 revised OECD Principles.

We strongly support the OECD Principles' greater emphasis on a 'comply or explain' approach, which recognises that there is no 'one size fits all' approach to governance and commend the OECD for confirming the importance of this approach to governance.

Our comments on the following pages are made with the intention of ensuring that the OECD Principles attain the greatest clarity for those seeking to apply them within the relevant national regulatory framework, and are also made with regard to the stakeholders that the OECD has in mind.

Detailed comments

I Ensuring the basis for an effective corporate governance framework

1 **On page 3, in I.1 (the first paragraph)**, the term 'soft law' is used. While we support the 'comply or explain' approach, we do not support the use of the term 'soft law'. There are two problematic aspects to the use of this term:

- The law is black letter — it is either the law or it is not.
- The use of the term 'soft law' could imply that the principles-based approach taken is lacking in some way and that therefore black letter law intervention is required.

We recommend that any contrast with black-letter law should be framed as a 'principles-based approach', rather than 'soft law'. This is the language that is used in relation to governance codes in those jurisdictions that have implemented a 'comply or explain' approach.

2 **On page 3, in 1.2**, we query whether the word 'continuous' is appropriate ('effective and continuous consultation with the public'). We suggest that 'ongoing' may be a more appropriate word.

3 **On page 4, in I.B.6**, we support the OECD seeking to address the preponderance of other governance guidelines issued by multiple parties, including intermediaries acting collectively on behalf of asset owners as well as individual asset owners, fund managers, proxy advisers and shareholder groups. While there can be commonality in some areas between these multiple guidelines, they can also conflict and be prescriptive at times.

We are of the view that it would be useful to include an additional sentence in this paragraph that notes that, when formulating a national standard as an explicit substitute for legal or regulatory provisions, a consensus-based approach involving key market participants is also helpful in ensuring understanding and compliance. In Australia, there are 21 stakeholders on the ASX Corporate Governance Council, representing constituencies of all market participants, and this model has been very successful in improving corporate governance in Australian listed companies since the release of the first edition of the *Corporate Governance Principles and Recommendations* in 2003.

4 **On page 5, in I.D.8**, we have concerns with the second sentence that currently reads: 'This is where stocks and voting rights change hands and where the economic value of governance efforts is manifested'. Good governance is a mechanism for better decision making within companies, and better accountability to shareholders for those decisions. This is very different from postulating that good governance will lead to a higher share price, which the current sentence suggests. Good governance can still be in play even when a share price is decreasing, due to particular circumstances that may be beyond the company's control.

II The rights and equitable treatment of shareholders and key ownership functions

1 **On pages 8—9, in II.C.20**, we have concerns with the sentence 'Other impediments included prohibitions on proxy voting, the requirement of personal attendance at general shareholder meetings to vote, holding the meeting in a remote location and voting by show of hands'.

Voting by a show of hands is not an impediment. It can, however, be misused. We recommend that the sentence be recast, including the additional sentence we have suggested, as follows:

Other impediments included prohibitions on proxy voting, the requirement of personal attendance at general shareholder meetings to vote, and holding the meeting in a remote location, and there can also be a misuse of voting by show of hands. The option to include voting by poll should always be available to make sure the will of shareholders is ascertained.

2 **On page 10, in section II.5.24**, we query whether the first sentence continues to be appropriate, given that the Principles are intended to guide policy makers over coming years. It states that: 'The Principles recommend that voting by proxy be generally accepted.'

The appointment of a proxy to cast a vote interposes the law of agency between the shareholder and the corporation and is therefore by its nature indirect. This is currently generally seen as the only model for absentee voting, yet at a time of renewed interest in shareholder participation combined with the advent of technology, it is difficult to see how appointing a proxy as the only form of absentee voting at general meetings should remain the generally accepted system for voting.

The process of appointing a proxy to register a vote has the potential for abuse, as shareholders temporarily transfer to another party some of the rights attached to their membership, especially their right to attend a meeting and vote, or choose not to vote.

We have seen significant problems with the system of proxy voting, including the management of related parties in voting and the voting of undirected proxies. The complexities of the proxy voting system have also seen lost votes from institutional shareholders.

Proxy voting is anachronistic — a symbol of a bygone age where people had the need to appoint an individual to attend and vote on their behalf. We recognise that it is widely accepted, but if we were developing a system for voting from scratch at the present time, given the advent of technology that renders online direct voting easy and accessible, it is difficult to imagine that the system of proxy voting would be the chosen system.

Direct voting enables shareholders to exercise their voting rights without the need to attend meetings (which may not always be practicable) or to appoint proxies or representatives over whom they may have no control. Like all other types of voting, a shareholder completes a voting form which can be lodged by post, by fax or electronically and must be lodged, as for proxies, before the meeting. However, unlike a proxy, direct voting constitutes a binding instruction to the company and its registry which cannot be either altered or misinterpreted by any other person.

Direct voting improves the exercise of voting rights because it removes the intermediary between the shareholder and the company. Shareholders need no longer transfer some of their rights to another party.

Another significant advantage is that voting forms become clearer and easier to understand. Most proxy forms are necessarily highly legalistic and may be difficult for shareholders, particularly retail shareholders, to understand, due to the complexities of the proxy voting system. If shareholders received a direct voting form only, it would consist of a simple form setting out a series of resolutions on which they were asked to vote, but there would be no lengthy and complex explanation, as now, of:

- how the appointment of a proxy works
- the effect of appointing a proxy in relation to any voting exclusions
- the difference between a directed and undirected proxy
- the need to expressly authorise the chair to vote on a shareholder's behalf.

By replacing the system of proxy voting with direct voting, these issues become redundant and the system ensures that the result of all resolutions is the will of the eligible shareholders that voted on them. Shareholders would still retain the right to appoint a representative to attend the meeting and speak on their behalf.

At this point in time, given that online voting is becoming commonplace, we strongly encourage the OECD to revise its statement that: 'The Principles recommend that voting by proxy be generally accepted.' We recommend that the OECD 'future-proof' the OECD Principles by referring to the historical acceptance of proxy voting and encouraging the adoption of direct voting.

In this same section, we also note that various jurisdictions already have a regulatory framework in place that allows, under particular circumstances, for treasury shares and shares of the company held by subsidiaries to be voted, and so it is difficult to support the current statement that it is good practice not to allow such shares to be voted. We recommend that this sentence be recast as follows:

> Jurisdictions should, as part of their regulation of related parties, consider whether treasury shares and shares of the company held by subsidiaries should not be allowed to vote, nor be counted for quorum purposes.

3 **On page 10, in II.6.25**, we are of the view that it is important to emphasise that investors choose to hold their shares through intermediaries. This section canvasses the challenges in respect of foreign investors determining the entitlement to use their voting rights, and also speaks to business practices that provide further challenges to the exercise of voting rights. However, the current drafting implies that foreign investors have no choice in how their shares are held. We recommend that the first sentence be recast as follows:

> Foreign investors often choose to hold their shares through chains of intermediaries.

III Institutional investors, stock markets, and other intermediaries

1 **On page 15, in III.42 (the first paragraph)**, the first sentence is seeking to speak to the changed circumstances of the relationship between the shareholder and a company, which is no longer direct. However, the current wording is highly ambiguous, as this is not an economic reality but a reality born of globalisation, technology and dispersed shareholdings. Economic factors have fed into this, but other factors are also at play. Essentially, most corporations law is predicated on an anachronistic view of the relationship between the shareholder and the company, which is determined as being a direct relationship — see our earlier comments about proxy voting, which system is based on a shareholder being able to nominate another shareholder to attend and vote on their behalf at general meetings, because historically there was no other means possible of exercising voting rights if the shareholder could not attend a meeting personally. We recommend that this sentence be recast.

2 **On page 15, at III.44 and the heading to III.45**, the question arises as to whom disclosure by institutional investors is aimed. This needs to be clarified. Disclosure should be to the members of the pension fund or similar, and to the companies in which they invest, but it should not be a requirement that there is disclosure to the public in general.

In this same paragraph, there is a reference to the adoption of 'stewardship codes'. In Australia, consultation on this issue by the Corporations and Markets Advisory Committee (an advisory body to the Australian Government on corporations and markets law) did not give rise to calls for the adoption of a stewardship code in this jurisdiction. However, Governance Institute, in partnership with Sandy Easterbrook and in consultation with representatives from ASX-listed companies, asset owners, asset managers and intermediaries, each with direct presence in this

market, developed principles and guidelines on shareholder engagement (*Improving engagement between ASX-listed companies and their institutional investors: Principles and Guidelines*, 2014, available at **governanceinstitute.com.au/shareholderengagement**). They also take into account input from a public consultation on the exposure draft.

We recommend that this sentence be recast as follows:

> In recent years, some countries have begun to consider adoption of so-called "stewardship codes", that investors are invited to sign up to on a voluntary basis, or other forms of guidance developed by consensus between investors and companies.

3 **On page 17, in III.D.53**, we suggest that the first two sentences could be revised slightly to read: 'The investment chain from ultimate owners to corporations may involve multiple intermediary owners, as well as a wide variety of professions that sell advice and services to intermediary owners'.

IV The role of stakeholders in corporate governance

1 **On page 20, in IV.A**, we recommend, that for the sake of consistency (with the preceding heading), it would be best to replace the words 'law or through mutual agreements' with 'law, international agreements or mutual agreements'.

2 **On page 21, in IV.B.63**, we recommend that an additional sentence be inserted to clarify that stock ownership by employees assists in aligning the interests of employees with shareholders. We recommend that this additional sentence be inserted after the sentence 'With respect to performance enhancing mechanisms, employee stock ownership plans or other profit sharing mechanisms are to be found in many countries'.

3 **On page 21, in IV.D.64**, again, for the sake of consistency (with section I at the beginning of the Principles), we recommend that it would be best to replace the words 'corporate governance systems' with corporate governance frameworks'.

V Disclosure and transparency

1 **On page 23, in V.69,** we are of the view that a slight redrafting is required to accurately reflect how corporate information is disclosed to the market. Currently the sentence states: 'They also support simultaneous reporting of information to all shareholders in order to ensure their equitable treatment'. It is not accurate to say that there is simultaneous reporting to all shareholders, as the information is not sent to them directly. We recommend that the sentence read as follows:

> They also support simultaneous reporting of information that all shareholders can access in order to ensure their equitable treatment.

2 **On page 28, in V.D.97**, we recommend that additional material be included noting it is good practice for the auditor to be available at the general shareholders' meeting to take questions from shareholders.

VI The responsibilities of the board

1 **On page 30, in VI.A.104**, we recommend that the words 'or an obligation to pursue aggressive tax avoidance' be deleted. The sentiment can be applauded but it is in the wrong place. We also note that the matter is dealt with in VI.C.106 on page 31, which is the appropriate place.

2 **On page 32, in VI.D.3.110**, we are of the view that an essential board responsibility is missing — the appointment and removal of the CEO. We appreciate that this is a responsibility of a unitary board rather than a two-tier board, but it is central to the matter set out in the subheading, which is 'Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing success planning'. At present this section deals only with a two-tier board, rather than all boards. We recommend that the following sentence be inserted:

> A key responsibility of a unitary board is the appointment and removal of the CEO and succession planning of key executives.

3 **On page 32, in VI.D.4.111**, the term 'longer run interests' in the second sentence should read 'longer term interests'.

4 **On page 32, in VI.D.4.112**, we note that, while we support clawback provisions being included in employment contracts for key executives, malus provisions are fraught with difficulty and may not always be appropriate. We therefore do not support the inclusion of malus provisions in this section as 'good practice' and recommend that this be deleted. We also note that the inclusion of malus provisions in this section is very UK-centric. Malus provisions have been introduced in the United Kingdom, but the particularities of one regulatory regime should not be assumed to be transferable to all jurisdictions.

5 **On page 33, in VI.D.5.113**, we do not support the involvement of shareholders in the day-to-day management of the company, which this section currently recommends. Corporate law in all jurisdictions of which we are aware provides that the business of the company is to be managed by or under the direction of the directors; that is, the directors are to exercise all the powers of a company except any that the law or the company's constitution (if any) requires the company to exercise in general meeting. The general meeting is not given express powers with respect to the conduct of the company's business. Shareholders are given qualified powers over the composition of the board of directors in whom management powers are vested. Without such provisions that provide that the business of the company is to be managed by the directors, only the members in general meeting could manage the business of the company. As recognised by corporations law globally, and given the development of widely held corporations, this is not feasible.

The current drafting of section VI.D.5.113 provides that shareholders should be given the right to be involved in the nomination process for board appointments. We do not support this as good governance. However, we do support the right of external candidates to nominate for board positions, and for shareholders being given the right to elect and remove directors. We recommend that the paragraph be redrafted as follows:

> These Principles promote a role for shareholders in the election and removal of board members. The board has an essential role to play in ensuring that this and other aspects of the nominations and election process are respected. First, while actual procedures for nomination may differ among countries, the board or a nomination committee has a special responsibility to make sure that established procedures are transparent and respected. Second, the board has a key role in defining the general or individual profile of board members that the company may need at any given time, considering with the appropriate knowledge, competencies and expertise to complement the existing skills of the board. Third, the board or nomination committee has the responsibility to identify potential candidates to meet desired profiles and propose them to shareholders, and/or consider those candidates advanced by shareholders with the right to make nominations. . There are increasing calls for an open search processes extending to a broad range of people. Shareholders should have the right to appoint and elect directors.

6 **On page 34, in VI.E.121**, we recommend that additional material be included covering the importance of a reporting line for the company secretary to the chair on all board matters, which would be separate from the reporting line of the company secretary in their role as a an executive. We recommend that the following be inserted:

> The company secretary should have a reporting line to the board on all matters to do with the proper functioning of the board.

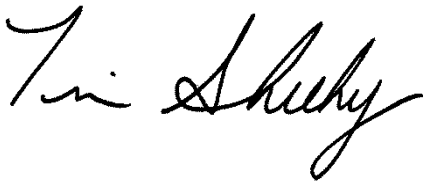
We have one final comment, which is that the language used throughout in relation to remuneration should be consistent. We note that at times the word 'compensation' is used, for example, in subheading VI.D.3 on page 32 and in paragraph VI.I.127 on page 35.

Conclusion

We look forward to seeing the final version of the revised OECD Principles of Corporate Governance.

Please do not hesitate to contact us should you have any queries. Any queries can be directed to our National Director, Policy & Publishing, Judith Fox, at judith.fox@governanceinstitute.com.au.

Yours sincerely



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