

OECD Corporate Governance Committee

4 January 2015

**Re: OECD Principles of Corporate Governance**

CFA Institute<sup>1</sup> appreciates the opportunity to comment on the review of the OECD Principles of Corporate Governance. CFA Institute represents the views of investment professionals before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and on issues that affect the efficiency, integrity and accountability of global financial markets.

**Summary**

We understand the importance of the revisions the OECD is making to its corporate governance principles, as few corporate governance documents have been as influential throughout the years in shaping global governance as the OECD Principles – from when they debuted in 1999 to today. As an association of professional investors we have long supported strong corporate governance principles as a means of maximizing investor protection and board accountability at public companies. Corporate governance, therefore, is a factor that investors cannot ignore but should assess carefully in seeking the best possible results for themselves and their clients. At its core, corporate governance is the arrangement of checks, balances, and incentives in place in order to minimize and manage the conflicting interests between insiders and external shareowners. We therefore thank the OECD for taking on the responsibility of updating this code, and of setting a framework for better corporate governance worldwide.

**Specific Comments**

**I. Ensuring the Basis for an Effective Corporate Governance Framework**

**B. The legal and regulatory requirements that affect corporate governance practices should be consistent with the rule of law, transparent and enforceable.**

5.

CFA Institute agrees that a corporate governance framework should promote transparent, efficient and fair markets. We also agree on the importance of public authorities to have

---

<sup>1</sup> CFA Institute is a global, not-for-profit professional association of more than 120,000 investment analysts, advisers, portfolio managers, and other investment professionals in 146 countries, of whom nearly 115,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 139 member societies in 60 countries and territories.

effective enforcement and sanctioning powers to deter dishonest behavior and help ensure sound corporate governance practices. In a recent global survey of CFA Institute members, “improved enforcement of existing laws and regulation as well as improved corporate governance practices” was seen as critical in both local and global markets to improve investor trust and market integrity.<sup>2</sup> Finally, we agree that this framework needs to be consistent with the rule of law to ensure both their legitimacy and their enforceability.

#### **D. Stock markets should be regulated in a way that supports effective corporate governance**

8.

We realize that all companies in a given market are not homogeneous and that regulators should have some discretion in creating standards that serve companies with different characteristics. However, we are also wary of too much leeway in governance standards, and endorse a strong core of corporate governance principles as a threshold for access to public capital markets – no matter the size or maturity of companies.

We are encouraged by the language in these draft principles calling on stock markets to be regulated in a way that supports effective corporate governance. The listing standards of the markets around the world set a baseline for corporate governance that, if set too low, can harm investors and result in an inefficient use of capital in that market. We encourage the OECD to continue to push for high corporate governance standards from global stock exchanges.

9.

Many stock exchanges are themselves publicly listed entities, leading to a fundamental conflict when these exchange act as both standards-setters and for-profit entities depending on listing fees from those they regulate. Regulators must ensure that the rights of investors are not compromised by lax exchange listing standards. High standards of corporate governance are important in enhancing foreign investors’ confidence that their rights are protected when investing outside their own market, and therefore play a pivotal role in attracting capital to a market.

10.

We agree that policy makers and regulators should assess the proper role of stock exchanges and trading venues in terms of standard setting, supervision and enforcement of corporate

---

<sup>2</sup> The CFA Institute Global Market Sentiment Survey was created to seek input from CFA Institute members and gather feedback on market sentiment, performance, and market integrity issues, and to further our mission of promoting ethical and trustworthy investment markets. An online survey was conducted from 14 to 28 October 2014. All CFA Institute members globally were invited to participate in the survey; 5,259 responded, for an overall response rate of 4% and a margin of error of  $\pm 1.3\%$ .

governance rules. We also agree that effective regulation of corporate governance requires an assessment of how different business models of stock exchanges affect their incentives and ability to carry out these functions that are sometimes costly and in many respects serve a public function.

**F. Cross-border cooperation should be enhanced, including through bilateral and multilateral arrangements for exchange of information.**

12.

Finally, we appreciate the OECD's call for enhanced cross-border cooperation, including bilateral and multilateral arrangements for the exchange of information. The work of OECD and other organizations to coordinate the setting of higher standards of corporate governance in international forums goes a long way towards raising the global understanding of governance best practices.

## **II. The Rights and Equitable Treatment of Shareowners and Key Ownership Functions**

CFA Institute would like the OECD to consider addressing "fee-shifting" corporate bylaws that have recently been adopted at a number of companies in the United States. Such bylaws require shareholders who sue companies to pay the legal fees of the company unless the shareholder wins the case in its entirety. Such bylaws can effectively eliminate any private regulation of corporate fraud, and are a threat to board accountability. Fee-shifting bylaws create prohibitively high hurdles for shareholders to pursue litigation for legitimate concerns.

**A. Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareowner meetings; 5) elect and remove members of the board; and (6) share in the profits of the corporation.**

CFA Institute agrees with the OECD in that the basic rights of shareowners should include these six specific rights. We encourage the OECD to alter the language to right #5 above by stating that the basic rights of shareowners should include the right to: 5) nominate, elect, and remove members of the board. The right to place nominees on the corporate proxy ballot – with reasonable controls and standards – helps ensure boards are accountable to the shareowners they represent.

**B. Shareowners should be sufficiently informed about, and have the right to approve or participate in, decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, or articles of incorporation or similar governing documents of the company;**

**2) the authorization for the issuance of additional shares; and 3) extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company.**

We support the OECD's statement.

**C. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures that govern general shareholder meetings:**

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

22.

We are encouraged by the OECD statement that shareowners should participate in the nomination and election of board members. There are still markets in which shareowners do not enjoy the ability to directly nominate directors.<sup>3</sup> We therefore encourage the OECD to clarify the language in this area, making it clear that it is considered best practice for shareowners to have the ability to directly nominate directors should those shareowners meet certain ownership standards. Such a right ensures greater board accountability, making sure that directors are answerable to shareowners. The right to merely suggest directors to the nominating committee does not go far enough in this regard.

23.

We agree with the Principles in calling for the disclosure of remuneration of the board and key executives, and especially the importance of information that allows shareowners to know the remuneration policy, as well as the total value of compensation arrangements made pursuant to this policy.<sup>4</sup>

CFA Institute also believes that companies should have to seek shareowner approval for matters that have a direct and material effect on shareowner wealth, while leaving matters relating to operational concerns for the board and management to decide. This approach to governance would require management to seek approval for issuance of stock options as compensation, compensation policies, mergers, acquisitions, divestitures, and capital structure

---

<sup>3</sup> Please see *Proxy Access In the United States: Revisiting the Proposed SEC Rule (2014)* for more of our thoughts on this topic.

<sup>4</sup> CFA Institute has created a *Compensation Discussion and Analysis Template* in order to help issuers create a CD&A document that adequately tells a company's story while providing investors with the information they need to make informed investment decisions. CFA Institute will be updating the manual in the first half of 2015.

decisions such as issuing large amounts of new equity shares or debt. Matters such as how to organize operating units, which products to develop and how to price and market them, or other non-capital decisions, would be left to management to decide.

In addition, companies should have to receive approval of independent shareowners prior to launching rights issues or open offers that would substantially (5% for example) increase issued share capital or market capitalization of the issuer. Insiders and control groups may use large rights issues or open offers to dilute smaller and independent shareowners.

**5. Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.**

24.

We encourage the OECD to take a strong stand on the issue of “show-of-hands-voting.” We believe that poll-voting is a best practice and that practices such as show-of-hands voting disenfranchises shareowners and should be eliminated whenever possible.

25.

We agree that notice periods should ensure that foreign investors have in effect the same opportunity to exercise their vote as domestic shareowners. Likewise, we support elimination of any practice that encumbers the ability of foreign shareowners to exercise their voting rights.

**E. All shareholders of the same series of a class should be treated equally. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.**

**1. Within any series of a class, all shares should carry the same rights. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in voting rights should be subject to approval by those classes of shares which are negatively affected.**

28.

We further encourage the OECD to take a strong stance on the issue of one-share-one-vote. We believe that company rules should ensure that each share has one vote. A structure that permits one group of shareowners disproportionate votes per share creates the potential for a minority shareowner to override the wishes of the majority of owners for personal interest. Where such dual structures are legal, companies should disclose such arrangements and the situations, the manner, and the extent to which those arrangements may affect other shareowners.

**F. Related-party transactions should be approved and conducted in a manner that ensures proper management of conflicts of interest and protects the interest of the company and its shareholders.**

**1. Conflicts of interest inherent in related-party transactions should be addressed.**

34.

Concerning conflicts of interest and related-party transactions, we believe that issuers must inform investors and other parties about potential conflicts of interest affecting board members, management, auditors, and other significant shareowners. These disclosures are needed to enable market participants to understand and interpret whether the information that companies provide to them has the potential for manipulation as a result of any conflicting interests of the reporting parties. Ultimately, these disclosures will allow investors to make informed decisions.

35.

Companies should have appropriate thresholds for determining when related-party transactions require board and/or shareowner approval. Investors need to ensure that there are systems in place that monitor the legitimacy of major transactions pursued by company management. Board approval makes management more accountable, and shareowner approval makes management, as well as boards, accountable.

36.

When related-party transactions require board or shareowner approval, those board members or shareowners involved in the transactions should abstain from voting. Related parties, be they "interested" shareowners or directors, should abstain from voting to avoid potential conflicts of interest which could impair board objectivity.

**III. Institutional Investors, Stock Markets, and Other Intermediaries**

43.

The most effective and productive corporate governance structures rely on active and prudent shareowner engagement. We agree with the OECD that mandatory requirements for investors to engage with issues are likely to be ineffective and lead to box-ticking. CFA Institute does not endorse mandatory engagement of either shareowners or issuers; however, we are encouraged by the positive movement towards more engagement from these parties in recent years. We therefore encourage the OECD and other parties interested in promoting best practices in governance to advocate for best practices in engagement standards. International cooperation

concerning establishing best practices in engagement can only enhance the trend towards better and more engagement between issuers and investors.

**A. Institutional Investors acting in a fiduciary capacity, including asset managers, 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. Disclosure of actual voting records is considered good practice, especially where an institution has a declared policy to vote.**

CFA Institute agrees with the OECD that institutional investors acting in a fiduciary capacity, including asset managers, should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.

45.

Institutions also should disclose what actions they are taking to minimize the potentially negative impact on their ability to exercise key ownership rights. We concur that such actions may include the separation of bonuses for fund management from those related to the acquisition of new business elsewhere in the organization.

**D. The corporate governance framework should ensure that proxy advisors, analysts, brokers, rating agencies and others that provide analysis or advice relevant to decisions by investors, disclose and minimize conflicts of interest that might compromise the integrity of their analysis or advice.**

54.

CFA Institute agrees with this statement. Self-regulatory efforts such as the recently completed *Best Practice Principles for Shareholder Voting Research*<sup>5</sup> lay out a set of best practices for proxy advisers and governance research providers that will allow investors to better understand the quality of service they can expect from these firms. The approach the report advocates also would help investors understand any potential conflicts of interests present at the firms. We believe the OECD should endorse such efforts in its Principles.

#### **IV. The Role of Stakeholders in Corporate Governance**

No comments in this section.

#### **V. Disclosure and Transparency**

---

<sup>5</sup> The Best Practice Principles Group (BPPG) was formed in February 2013 to promote greater understanding of the proxy research industry. In March 2014 the final Principles were published.

**A. Disclosure should include, but not be limited to material information on:**

Shareowners need to know their rights in order to make informed, responsible investment decisions.<sup>6</sup> This requires reasonable and timely access to relevant and accurate information about issues affecting their investments, including an understanding of the engagement customs and legal and regulatory framework of the market(s) in which they invest. We encourage the OECD to advocate for timely access to the information investors need to make informed investment decisions.

In order to properly exercise their rights, shareowners need to know information about any limitations on their rights; whether a company elects directors using a majority-voting standard; their eligibility to approve significant company transactions; any ability to submit dissident resolutions at an annual meeting; how to participate in share voting – in person or otherwise; and opportunities and responsibilities for shareowner engagement in such cases as cumulative and confidential voting or advisory votes on compensation.

**VI. The Responsibilities of the Board**

CFA Institute believes that a diversified and qualified board of directors that truly represents the interests of shareowners is best qualified to oversee and consider management actions and decisions. A qualified board of directors oversees management, but does not get involved in the day-to-day running of the business. Such a board is able to balance the need to let management formulate business plans, enter into transactions and contracts on behalf of the company, and make relevant decisions, while still representing shareowners, and holding management accountable.

We also feel that corporate directors should fulfill their duty of loyalty, prudence and care towards their company's shareowners. Directors are representatives of shareowners and are stewards of their interests. They oversee managers who are tasked with executing the strategy approved by the directors in a manner that maximizes shareowner value.

101.

Among its many roles, a board of directors is responsible for establishing accountability for company management and assuring reasonable internal controls through independent third-party reviews of the company.

**A. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.**

---

<sup>6</sup> CFA Institute Published *Shareowner Rights across the Markets* in 2013 in order to provide investors with information about their rights in 28 markets around the world.



104.

The brief mention of the board's role in pursuing aggressive tax avoidance is mentioned in board responsibilities section on page 30 of the draft Principles. This reference seems out of place and rather specific. We question its inclusion in the current document.

**D. The board should fulfill certain key functions, including:**

**8. Overseeing the process of disclosure and communications.**

118.

Concerning communications with investors, board members should ensure that the information that management provides to shareowners is timely and provides investors with the information they need in order to make timely investment decisions. Investors' needs for material price-sensitive information outweigh the company's need for confidentiality in most cases. Companies can adopt a formal board-shareowner communication policy that identifies the type of shareowner concerns boards will consider appropriate for engagement, the form of communications engagement that a board will use, and which representatives of the company will serve as the primary points of investor contact. Boards should endeavor to make conversations between issuers and investors more routine.

**E. The board should be able to exercise objective independent judgment on corporate affairs.**

120.

An independent board Chair most effectively avoids conflicts inherent when the same person is CEO and Chair. In instances where the CEO also is the chairman, independent board members should appoint a lead director whose role is to chair separate meetings of independent directors and address other issues that may involve conflicts with management. This approach strikes an appropriate balance for ensuring the continued independence of board deliberation and decision-making processes.

124.

Concerning the independence of boards, we believe that company boards should have an independent majority. The definition of independence however can mean different things in different jurisdictions, so we encourage the OECD to set broad principles of what constitutes an independent director and beyond that encourage local jurisdictions to adopt their own clear definitions of independence.

125.

An independent majority on the board is more likely to consider the best interests of all shareowners first rather than solely the interests of insiders. It also is likely to foster independent decision-making and to mitigate conflicts of interest that may arise. The nomination, compensation, and audit committees should be composed entirely of independent directors and should have written charters establishing their purpose, responsibilities, member qualifications, structure, operations, and manner of reporting to the full board. Removing management or insider influence from these committees will enable these committees to act with independence in overseeing the actions and decisions of management, in ensuring that the decisions are made from the perspective of serving shareowners' interests, and in nominating new members for the board.

**3. Board members should be able to commit themselves effectively to their responsibilities.**

128.

We agree that board members should be able to commit themselves effectively to their responsibilities. Board members should therefore limit the number of board memberships they accept at any one time so that they can effectively serve the interests of the shareowners of the companies they serve. Limiting the number of board mandates provides board members with more time to adequately consider the issues affecting a company and to decide on matters in a manner that serves shareowners' best long-term interests.

**Concluding Remarks**

CFA Institute welcomes the opportunity to comment in the updated Principles of Corporate Governance from the OECD. We recognize the influence the OECD Principles of Corporate Governance have on global governance and we are therefore encouraged by some of the best practices advocated by the OECD. Please feel free to contact us with any questions or comments.

Yours faithfully,

Kurt Schacht, CFA, JD  
Managing Director  
Standards and Financial Market Integrity Division  
CFA Institute  
+1 212.756.7728  
kurt.schacht@cfainstitute.org

Matt Orsagh, CFA, CIPM  
Director, Capital Markets Policy  
CFA Institute  
+1 212.756.7108  
matt.orsagh@cfainstitute.org