Recent Developments in Philippine Corporate Governance: The New Code of Corporate Governance for Publicly-Listed Companies

The Philippine Securities and Exchange Commission (SEC) recently released a new Code of Corporate Governance for Publicly-Listed Companies (CG Code) last 22 November 2016. The CG Code is the first action item for implementation in the Philippine Corporate Governance Blueprint launched on November 2015 and is the first of a series of CG Codes for different types of Philippine corporations under the SEC’s supervision. It was drafted with the assistance of the International Finance Corporation and in consultation with various regulators and stakeholder groups such as the Bangko Sentral ng Pilipinas, Insurance Commission, Philippine Stock Exchange, USAID i3, Shareholders’ Association of the Philippines, Management Association of the Philippines, Institute of Internal Auditors Philippines, Good Governance Advocates and Practitioners of the Philippines and Institute of Corporate Directors. It is available for download from the SEC website: www.sec.gov.ph.

The intent of the new CG Code is to raise the corporate governance standards of Philippine corporations to a level at par with its regional and global counterparts. The latest G20/OECD Principles of Corporate Governance and the ASEAN Corporate Governance Scorecard were used as key reference materials in the drafting of this Code.

The main feature of this new Code that deserves emphasis is the adoption of the “comply or explain” approach, which differs from the combined mandatory/voluntary approach of the previous CG Code. This approach combines voluntary compliance with mandatory disclosure. Companies do not have to comply with the Code but they must disclose in their annual corporate governance reports whether they complied with the Code provisions, identify any area of non-compliance, and explain the reasons for non-compliance and how the over-all CG Principle recommended in the Code is still being achieved.

The adoption of the “comply or explain” approach is in recognition of the fact that there is no “one size fits all” in corporate governance. Under this approach, companies are given flexibility in determining their corporate governance arrangements while also giving the market the power to decide whether these arrangements are indeed good practices. In this way, companies become accountable to their shareholders, who can choose to pull-out their investments and sell their shares if the companies’ CG practices falls below recognized standards. Hence, the penalty for poor CG is market-driven rather than regulator imposed.

The Principles of Proportionality is also considered in the application of the provisions of the new Code. This is to recognize that not all publicly-listed companies are similarly situated. There are Philippine PLCs that would be bigger and have more complex operations than others and as such, would be more able to comply with the CG practices recommended in the Code.

In addition, the new Code has an increased focus on the areas of Disclosure and Transparency, Internal Control and Risk Management and the Role of Stakeholders. Further, there is also an item on Sustainable Development, taking into consideration economic, environmental, social and governance (EESG) concerns.

The new Code has sixteen (16) principles that are distributed among five (5) main sections, namely:

1. Board’s Governance Responsibilities – Principles 1 – 7
2. Disclosure and Transparency – Principles 8 – 11
Principle 1 is on establishing a competent board to foster the long-term success of the corporation and to sustain its competitiveness and profitability in a manner consistent with its corporate objectives and the long-term best interests of its shareholders and other stakeholders. The recommended good corporate governance practices under this principle include having a board composed of a majority of non-executive directors and having a policy on the training of directors.

Principle 2 is on establishing clear roles and responsibilities of the board, which should be clearly made known to all directors as well as to shareholders and other stakeholders. This principle provides an overview of the fiduciary duty and responsibility of the Board.

Principle 3 is on establishing board committees, which should be set up to the extent possible to support the effective performance of the Board’s functions. Under this principle, it is recommended that all PLCs have Audit and Corporate Governance Committees. The Corporate Governance Committee can perform the functions of the Nomination and Remuneration Committee. A Board Risk Oversight Committee and Related Party Transaction Committee is recommended also subject to a corporation's size, risk profile and complexity of operations.

Principle 4 is on fostering commitment. To show full commitment, the director should devote time and attention to properly and effectively perform his duties. Its Recommendations include a limit of five (5) directorships in publicly-listed company for non-executive directors and prior notice to the incumbent board before accepting a directorship in another company.

Principle 5 is on reinforcing board independence and states that the Board should endeavour to exercise an objective and independent judgment on all corporate affairs. Among the recommendations under this Principle are the following: (1) the Board should have at least three independent directors, or such number as to constitute at least one-third of the Board, whichever is higher; (2) the independent director should serve for a maximum cumulative term of nine years; and (3) there should be a lead independent director if the Chairman of the Board is not independent.

Principle 6 is on assessing board performance which states that board should regularly carry out evaluations to appraise its performance and whether it possesses the right mix of backgrounds and competencies. An annual self-assessment of the board's performance, including the performance of the Chairman, individual members and committees is recommended. It is further recommended that every three years the assessment should be supported by an external facilitator.

Principle 7 is on strengthening board ethics and provides that members of the board are duty bound to apply high ethical standards, taking into account the interest of all stakeholders. Under this principle, it is recommended that Boards adopt a Code of Business Conduct and Ethics and ensure the proper and efficient implementation and monitoring of compliance with said Code.

Principle 8 is on enhancing company disclosure policies and procedures and states that the company should establish policies and procedures that are practical and in accordance with best practices and regulatory expectations. Included are recommendations on disclosure of policies governing Related Party Transactions and on full disclosure of all relevant and material information on individual board members.

Principle 9 is on strengthening the external auditor’s independence and improving audit quality. The recommendation under this principle focus on having a robust process for the appropriate selection of an external auditor and disclosure of the nature of non-audit services performed by the company’s external auditor to deal with any potential conflict of interest.
**Principle 10** is on increasing focus on non-financial and sustainability reporting. It provides that the company should ensure that the material and reportable non-financial and sustainability issues are disclosed.

**Principle 11** is on promoting a comprehensive and cost-efficient access to relevant information which is crucial for informed decision-making by investors, stakeholders and other interested users.

**Principle 12** is on strengthening the internal control system and enterprise risk management framework. This principle states that to ensure integrity, transparency and proper governance in the conduct of its affairs, the company should have a strong and effective internal control system and enterprise risk management framework.

**Principle 13** is on promoting shareholder rights and provides that the company should treat all shareholders fairly and equitably, and also recognize, protect and facilitate the exercise of their rights. Among the recommendations to promote shareholders rights are ensuring that the notice of Annual Shareholders’ Meeting are sent out at least 28 days before the meeting and establishing an Investor Relations Office to ensure constant engagement with its shareholders.

**Principle 14** is on respecting rights of stakeholders and effective redress for violation of stakeholders’ rights. Where stakeholders’ rights and/or interests are at stake, stakeholders should have the opportunity to obtain effective redress for the violation of their rights. It is recommended that the company identify its various stakeholders, promote cooperation between them and the company, establish clear policies and programs to provide a mechanism on the fair treatment and protection of shareholders and have a process that allows stakeholders to communicate with the company.

**Principle 15** is on encouraging employees’ participation. The key recommendation under this principle is the establishment of a suitable framework for whistleblowing that allows employees to freely communicate their concerns about illegal or unethical practices, without fear of retaliation and to have direct access to an independent member of the board or unit created to handle whistleblowing concerns.

**Principle 16** is on encouraging sustainability and social responsibility, which puts emphasis on the company’s social responsibility in dealing with its various stakeholders. The company should recognize the interdependence between its business and the society where it operates and promote a mutually beneficial relationship between the two.

Most relevant to the agenda of this meeting is **Principle 10** under Disclosure and Transparency which is on increasing focus on non-financial and sustainability reporting and states that the company should ensure that the material and reportable non-financial and sustainability issues are disclosed. It is recommended that the Board should have clear and focused policy on the disclosure of non-financial information, with emphasis on the management of economic, environmental, social and governance (EESG) issues of its business. It is further recommended that companies adopt a globally recognized standard/framework in reporting sustainability and non-financial issues.

The inclusion of this Principle and Recommendation in the new CG Code highlights the SEC’s thrust to introduce and showcase EESG and Sustainability Reporting as a good corporate governance practice for Philippine corporations. Albeit not yet mandatorily required, Philippine PLCs would still be compelled to explain why they do not comply with this recommendation.

In addition to **Principle 10**, it is also specifically included under **Recommendation 12.4 (Internal Control System and Risk Management Framework)** that the risk management function involves identifying and analyzing key risk exposures relating to EESG factors in recognition that due consideration should be given to EESG risks.
To sum up, the new CG Code aims to increase the responsibilities of the board and ensure the competence and commitment of the directors. Further, it hopes to strengthen the protection of shareholders and other stakeholders, as well as promote full disclosure and transparency in both financial and non-financial reporting.