IMPROVING THE EFFECTIVENESS OF CORPORATE GOVERNANCE CODES
Approaches to Corporate Governance Codes

Corporate Governance Regulations By Type

- Codes in countries with capital markets (113 total)
- Only includes codes that apply to listed companies

- Comply or Explain, 65
- Voluntary, 25
- Mandatory, 7
- Mandatory+C/E, 7
- No Code, 9

Source: World Bank Corporate Governance Codes Database
Steps to improve effectiveness

1. Clarify the comply-or-explain requirement.
2. Enforce corporate governance disclosure requirements
3. Improve how companies “comply-or-explain”
4. Report on market compliance (scorecard)
5. Consider active enforcement of the quality of the disclosure statements.
6. Consider moving from a comply-or-explain requirement to a mandatory regulation
7. Adopt a stewardship code
1. Clarify the Comply or Explain Requirement

- Comply or explain is poorly understood in many (if not all) countries.
- Key steps include:
  - Clarify the legal requirement
  - Capacity building of regulators
  - Capacity building in companies
  - Awareness raising
2. Enforce the existing CG disclosure requirements

- In many countries there is no surveillance or monitoring by the regulator
  - Typical (where code is voluntary)
  - Sometimes true in practice even when there is a disclosure requirement

- Enforcing basic compliance with disclosure requirement can improve quality of code disclosures
  - Surveillance by regulator that CG statement is made.
  - Quality and level of compliance assessed by shareholders etc.
  - Dissatisfaction with quality of disclosure statements remains
3. Improve “how” companies comply-or-explain

Options:

• **Simple compliance statement in the annual report**
  • “We comply with the code of corporate governance”
  • Explanation only necessary in case of deviation
  • Most common. Light touch but: dissatisfaction with quality of disclosure statements

• **“Apply and Explain”**
  • Like first option but must disclose even when in compliance.
  • More complex reports (or corporate governance statements)

• **Mandatory “questionnaires”**
  • 11 countries require completion of detailed questionnaires, either sent to regulator, posted on website, or attached to annual report or management report.

• **Key issue**: Complexity of reporting
4. Report on Market Compliance

Options:

• **No reporting on code / code compliance by the regulator**
  • Typical (where code is voluntary)
  • Sometimes true in practice with disclosure requirement

• **Periodic report by regulator** (sometimes with annual report)
  • Summary statistics on compliance
  • Costly to produce

• **Periodic reports by other stakeholders**
  • Could include scorecard-type process

• **“Name and Shame”**
  • Periodic reports with company names included
  • Scorecards with full company rankings

• **Key issues**: resource requirements, ability of regulators to name and shame.
5. Consider active enforcement of corporate governance disclosure statements

- A few regulators actively investigate and assess quality of statements (e.g. Portugal, Spain)
- Reviews of both completeness and depth
- Reviews combined with sophisticated reporting, ranking, etc.
- So new that no clear evidence of impact on quality
- **Key issue**: resources requirements and reputational risks for the regulator
6. Consider moving from a comply-or-explain requirement to a mandatory regulation

**Comply or explain:**
- Flexible, allows more aspirational codes covering a wider variety of good practice
- Encourages companies to think about how to adopt good corporate governance
- Involves investors in compliance
- Flexible
- But:
  - Lack of influence / awareness of codes (especially voluntary codes)
  - Lack of adoption of code provisions.
  - Poor quality of code disclosure statements
  - Lack of attention paid to code compliance by shareholders
  - Lack of monitoring, supervision, and enforcement by regulators / stock exchanges

**Mandatory:**
- Simpler and focused on structural issues
- No confusion
- Better compliance (at least on paper)
- But: risk of costs of CG regulations exceeding benefits
  - In many countries: concern about state of equity markets (delisting, liquidity, etc.). Mandatory regulation may reduce the incentives for companies to list and participate in public markets.
  - Flexibility especially important for:
    - Small companies vs. big companies
    - Foreign / multinationals vs. domestic companies
    - Regulated institutions (e.g. banks) vs. others with more flexibility.
- May also be expensive to enforce for supervisors
7. Adopt a stewardship code

- Stewardship code – assigns explicit responsibility to institutional investors to monitor companies, vote shares, and engage when they don’t comply
- Very few in emerging markets
- So new that no clear evidence of impact
- **Key issue**: new regulatory requirement for institutional investors