SUMMARY

Introduction

The high-level policy dialogue among European and key emerging markets is a dialogue space convened by the Global Corporate Governance Forum (Forum) and the U.K. Financial Reporting Council (FRC) to exchange practical lessons, experiences, and best practices in monitoring and enforcing corporate governance standards and principles.

This second dialogue continued the first meeting of its kind which was held in Stockholm, Sweden, in December 2009, where the main issues discussed where the balance between mandatory requirements in law versus voluntary and self-enforcing mechanisms, as well as evolving roles by regulators, shareholders, and the market in light of the global financial crisis. The Stockholm meeting report can be downloaded at: http://www.gcgf.org/ifcext/cgf.nsf/Content/WorkshopRegulationOfCGCodes2009

The current report summarizes discussion that took place around the five main sessions of the second high-level policy dialogue that took place in Brussels, Belgium, on 8 December 2010, as detailed below. The meeting was hosted by and took place at the Brussels office of the Confederation of Finnish Industries.

The meeting agenda, list of participants, and country presentations will be posted for downloading at the Forum’s website: www.gcgf.org. The country presentations provide details on the topics and issues that are summarized under each of the sessions below.

Session 1: Measuring success: implementation and monitoring tools and,
Session 2: What happens once the code is finalised: different enforcement mechanisms
The first two sessions were combined because of the overlapping subject matter. Mr. Christian Strenger, a member of the German Corporate Governance Commission and of the Forum’s Private Sector Advisory Group, called for increased coordination between supervisory bodies and stock exchanges to bring about increased alignment between implementation and enforcement. As was pointed out, no one questions the need for benchmarks that help set high-level yardsticks for corporate governance, but the real focus must be on ensuring the practical application of such enunciated standards and principles. We should applaud the existence of ever-increasing benchmarks but the focus on their implementation and enforcement must be the forefront consideration of all efforts by oversight authorities. Mr. Strenger pointed out the importance of country-specific measures in implementation and monitoring of corporate governance.

Additionally, presentations from Brazil, Sweden, and Ireland detailed each respective country’s experience on how the implementation, monitoring and enforcement of corporate governance codes were carried out:

- **In Sweden** the code operated within an entirely self-regulatory system, characteristic for Nordic countries, with no role for regulators or government. The code goes beyond the standard “comply or explain” by requiring companies that do not comply to explain what they did instead. The Swedish Corporate Governance Board, one of the three bodies owning the Code, issues an annual report on compliance, and the Stock Exchange monitors a sample of 20% of company reports every year to ensure that the necessary disclosure has been made.

- In Ireland, the Irish Stock Exchange jointly with the Irish Association of Investment Managers had commissioned a Report on Compliance with the Combined Code on Corporate Governance by Irish Listed Companies (the ‘Report’). The report found out that there is a high level of compliance by Irish listed companies with the Combined Code. However, one important area identified for improvement in the Report was the quality of disclosures provided by listed companies on how they apply the principles of the Code. For example, in certain areas some listed companies provided similar disclosures year on year despite the fact that the market conditions within which they operate have changed significantly, or in other instances the terms of reference of a board committee were outlined rather than the actual activities of the committee during the year. The Report identifies areas where opportunities exist for listed companies to enhance the meaningfulness of their annual report disclosures for investors.

The recommendations on disclosure in the Report are expected to be included as a new Annex in the Listing Rules - on a “comply or explain” basis. The aim is to achieve more meaningful disclosure and improve the
quality of explanations on corporate governance practices. Separate to this, the Irish central Bank had introduced a mandatory corporate governance code for banks and insurance undertakings.

- **In Brazil** companies choose voluntarily to comply with mandatory corporate governance requirements as a condition of listing on the Novo Mercado index. The stock exchange, Bovespa, can only amend these mandatory rules with the agreement of at least one-third of companies in the Novo Mercado index. Even with Novo Mercado which already sets stringent requirements that go above and beyond SEC rules and corporate law, there is room for corporate governance codes to push for practices of higher standards where the market may not be ready to fully embrace. In Brazil, for example, Bovespa is currently introducing higher standards that relate to the dispersion of ownership, which failing SEC and Novo Mercado companies’ approval, would be prime candidates for inclusion in other monitoring and enforcement mechanisms, such as corporate governance codes and scorecards.

Other points made in this session’s discussion included:

- There was no standard model that could define the appropriate role for regulators, stock exchanges and market participants in monitoring and enforcement, or the correct balance between “comply or explain” or voluntary codes and mandatory rules. This would vary from country to country.
- Some other markets had tried the Brazilian approach of encouraging companies voluntarily to adopt higher governance standards on a “high quality” segment of the market, but for this to succeed in raising standards there needed to be enough investor demand or companies would not see any benefit in doing so.
- There were also some other examples where stock exchanges or regulators had decided to make parts of the code mandatory or move them into regulations or rules. This only made sense if they felt it was appropriate to take proper enforcement action where these requirements were breached; if not, it was more sensible for them to be subject to “comply or explain”.
- Some of the proposed revisions to Novo Mercado rules by the Brazilian exchange, such as an update regarding takeover mechanisms, were not approved by the one-third requirement of Novo Mercado listed companies. As a result, Bovespa is studying the possibility of introducing a Takeover Code. The Egyptian Exchange (EGX) mentioned that what the Exchange cannot impose in listing rules could be added in the corporate law or executive regulations as done in Egypt with regard to takeover rules.
- Some stock exchanges used governance or ESG indexes (Egypt and MENA region) to raise awareness of the issues or to assess levels of compliance, with a similar purpose as the reports described in Sweden and Ireland. In
some countries company scorecards had been developed to provide investors and other monitors a quick overview of the level of corporate governance of the company. This could help them to find out what structures had been put in place, but was not sufficient for them to judge the overall quality of the governance.

MSCI Global ESG Indices

Fact sheets:
• MSCI World ESG Index
• MSCI USA ESG Index
• MSCI Global Environment Index
• MSCI KLD 400 Social Index
• S&P/Hawkamah Pan Arab ESG Index

• Luxembourg Stock Exchange follows EU Directives and monitors the implementation of the Code annually, but raised the issue that, due to an increase of regulation, listed companies could be interested in migrating to other MTF’s or less regulated markets. EGX and the Singapore Exchange mentioned that the Exchanges have a strong interest in maintaining quality listed companies as this will impact the exchanges’ branding and reputation. For example, JSE agreed to have more obligations in its listing rules beyond its mandate because its market regulator was weak in effective implementation.

• Checking the quality of compliance of smaller companies with the Code is more difficult. It is not advisable to leave the monitoring function to external auditors as they failed in the financial crisis.

• For profit exchanges, there is a separation between operational and regulatory functions of the exchange so usually listing function is done via a Listing Authority at the market regulator outside the scope of the Exchange. It is doubtful if regulators would have the required quality and sufficient capacity to implement the Code, which is a challenge nowadays.

• EGX mentioned that Egyptian Institute of Directors (EIOD) took a role in educating and training of market participants in the Egyptian market
including market regulator with regard to CG issues and that the process of training and education will be gradual in emerging markets.

- MSCI has recently focused on creating sustainability indices because it is an area of growth and focus by institutional investors. EGX mentioned that in cooperation with S&P and EIOD it has issued an ESG index that was launched in March 2010 and has YTD performed better almost double 21% than the EGX 30 benchmark index (9%). However, there is not enough publicity about ESG index among institutional investors though it is published on web site of the exchange.

- In Finland, the CG Code (the Code) is a result of cooperation between the Confederation of Finnish Industries, the Chamber of Commerce, the stock exchange and other market parties. It has a very high level of implementation amounting to 90%.

- In Egypt, the Code was not imposed on the market but there was a committee made up of legal experts, Stock Exchange, market regulator etc. which took OECD principles as a guideline but came up with the Code taking into account Egyptian context. CG Code in Egypt is voluntary. However, listing and disclosure rules are mandatory on all listed companies and they incorporate main CG issues. Listing rules were amended by EGX end of 2008 and listed companies (376) were given one year grace period to implement the rules, by end of November 2010, number of listed companies on EGX amounted to 213 due to vigorous implementation of listing rules.

- Recognising that effective governance was about behaviour and not just process, questions were also raised about whether regulators had the skills and capacity to engage sensibly with companies on the quality of their governance as well as its structure. Regulators might need training and development and this must be of keen consideration. Companies as well need more education on the corporate governance code – explaining what it is, how to report on the implementation and disclose information better.

- The question was asked whether their commercial interests meant that stock exchanges could not be relied on to monitor and enforce codes properly. Most participants felt that they could, pointing out that poor reporting and governance created a reputational risk for the exchange as well as for individual companies. Many stock exchanges managed potential conflicts of interest by have separate listing and surveillance departments.

**Session 3: Where do codes stand in light of world-wide regulatory reforms?**

The OECD presented an overview of current trends observed in code revisions and the degree to which revising countries are taking into account lessons and best practices emerging as a result of the global financial crisis. In brief:
OECD had issued a series of reports on the causes of the financial crisis and lessons to be learnt for corporate governance. OECD had observed that regulators were using various tools to respond to the crisis. The initial focus on regulation was now being followed by revisions to codes, and some codes that had been purely voluntary were being made subject to “comply or explain”. There was also a trend for developing separate corporate governance codes for banks;

At present OECD was undertaking a series of “peer reviews”, looking at how particular aspects of governance were being addressed in a number of countries (both OECD members and non-members). The first peer review had looked at executive remuneration, and a report would be issued in due course. Future reviews would look at institutional investors and board practices. It was not yet clear whether this work would lead to revisions to the OECD Principles.

Other points made in this session’s discussion included:

- Revisions to corporate governance codes were initiated for different reasons. For example in European countries changes were partly driven by the EU agenda, as well as in response to national events.
- In some markets pressure came from foreign investors who expected to see similar governance arrangements to those in place in their home markets; while this could be helpful in improving standards, it could be resisted by companies if those investors did not take account of the national business culture.
- In other markets there was little evidence that investors were interested in corporate governance and it was left to professional organisations and advisers to take the lead.
- In considering the introduction of more challenging code revisions or binding rules it was necessary to bear in mind the possibility that some companies might choose to leave listed markets if new requirements were made too onerous. On the one hand, this might improve the overall quality of governance on the listed market; on the other hand those companies that left the market would be outside the control of the stock exchange and regulators.
- The European Commission informed that it is currently preparing a green paper on corporate governance for listed companies, with a due target date of April 2011, which will examine critical contextual issues, such as shareholder engagement, corporate governance infrastructure, improving the “comply or explain” mechanism, and improving existing state of insufficient monitoring.

Session 4: Implementing codes at the company level: the investors’ perspective
RiskMetrics/ISS lead a discussion on the importance investors attach to, and their approach to assessing the quality of, corporate governance in investee companies. In brief:

- RiskMetrics/ISS serves over 1,300 institutional investors worldwide. In so doing, its benchmark corporate governance policy considers five factors: universal corporate governance principles such as transparency (the OECD Principles were a key reference document); national law; local best practice principles and codes; the governance practices of the company concerned; and, disclosures made by the company;
- RiskMetrics/ISS clients were divided between those that had their own guidelines which ISS applied on their behalf and those that used ISS’ standard guidelines. While one-third of ISS’ clients had their own guidelines, they accounted for 60% of the shares held by all clients;
- In assessing a company’s governance, the main issues RiskMetrics/ISS looked at were board composition and quality, executive remuneration, shareholder rights and anti-takeover mechanisms. In addition, there were unique issues in specific markets, such as problematic related party transactions (RPTs) in Asia and poor disclosure practices in some emerging markets.

Other points made in this session’s discussion included:

- There was some discussion about whether proxy voting services should give companies the opportunity to comment on assessments before they were given to clients. While this might be desirable in principle, in practice it could be difficult, particularly when company disclosures were only made available shortly before voting deadlines.
- There was a link between the quality of disclosure by companies and box-ticking by investors. Investors were likely to apply standard assumptions in the absence of timely information about companies’ actual practices. In the EU the Shareholder Rights Directive had led to improvements in the availability of information.
- There was a potential for conflicts of interest where proxy voting agencies provided services to companies that they were rating on behalf of their investor clients, which needed to be managed appropriately.
- For code oversight authorities and other regulators, proxy voting agencies could be a useful source of information about any issues of concern to investors.
- Where corporate governance shortcomings emerge, the common mistake is to point the finger at regulators and the stock exchange. Shareholders and investor have equal responsibility, and this side of the equation cannot be neglected.
- In looking at the quality of governance, institutional investors tend to give predominant attention to board-related matters (especially the quality of directors above and beyond questions of independence), followed by
issues of executive remuneration, and take-over mechanisms adopted by companies. Of note, also, institutional investors tend to follow a cookie-cutter approach by which they make comparisons based on their own markets without due deference to contextual market differences. ISS’ experience has been different. Most institutional investors do not appear to be interested in a cookie-cutter approach when voting their shares across borders. Instead, they look to local practices to inform their corporate governance decisions.

Session 5: Evaluating the impact of potential code changes

Chris Hodge gave a presentation on the process followed by the Financial Reporting Council when considering revisions to the UK Code. There were four stages:

- Identifying new developments and issues to do with the implementation of the code;
- Public debate and further research on these issues;
- Public consultation on proposed changes to the code, with a regulatory impact assessment; and
- Action to support implementation of the revised code after introduction.

Other points made in this session’s discussion included:

- The potential cost of code changes could not be ignored as even where they were subject to “comply or explain” there would be market pressure to comply. However it could be very difficult to quantify the costs.
- It was even more difficult to quantify benefits because of the difficulty of linking positive outcomes such as improved performance to any single feature of a company’s governance structure.
- When considering code changes it was necessary to look at other parts of the overall regulatory framework to try to avoid contradictory requirements being placed on companies.
- There was always a risk of unintended consequences, but thorough consultation should enable these to be identified.

Closing remarks

It was agreed that it would be useful to hold an annual forum to discuss a small number of major issues. It was suggested that one issue for the next meeting might be the role of shareholders in monitoring governance.

Some participants felt that it would be helpful to develop means by which oversight bodies could contact each other in between the annual events, for example to find out how other countries had approached a particular issue.
As a minimum the contact details of members of the European Corporate Governance Codes Network and countries working with the Forum should be circulated to enable those bodies to contact each other. The Forum would investigate whether it might be possible to set up some form of private forum on its website to facilitate exchanges and communication among the oversight authorities.

The Forum is currently revising its *Toolkit on Developing Codes of Best Practice*, with plans to issue a supplement publication of corporate governance scorecards. It would be helpful to engage participants from the high-level policy dialogue as peer reviewers in the development of the toolkit supplement and future practice group on the topic.