



Corporate Governance Developments in OECD and MENA countries

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14 October 2009

Overview

- The OECD's corporate governance standards
 - The OECD's approach
 - The OECD Principles in more detail
- OECD and the Financial Crisis
 - Latest thinking
 - Lessons learned
- Work of the OECD in the MENA region
 - relevance of OECD's work to the region
 - ongoing projects



The OECD's corporate governance standards

The OECD Principles of Corporate Governance

- OECD *Principles of Corporate Governance* first issued in 1999
- Revised Principles issued in 2004
- *OECD Methodology for Assessing Implementation of the OECD Principles* released in December 2006
- 2009 consultation concluded Principles relevant
- OECD *Guidelines for Corporate Governance of State-Owned Enterprises* issued in 2005

Core Elements of the OECD Principles

- I. Ensuring the basis for an effective corporate governance framework
- II. Basic rights of shareholders & key ownership functions
- III. Equitable treatment of shareholders
- IV. Role of stakeholders in corporate governance
- V. Disclosure & transparency
- VI. Board responsibilities

What is special about the OECD Principles?

- Represent a wide consensus on desired outcomes
- Generally, they are “aspirational”, not “minimum”, standards
- Emphasise functional equivalence – *i.e.* the means used to achieve the desired outcomes might vary depending on:
 - Legal & institutional frameworks
 - Economic conditions & market structures
 - Political & socio-cultural environment
- Therefore, can be applied in any jurisdiction (no excuse not to use)
- Effect on overall economic performance, market integrity and incentives for market participants to be considered
- Assessments require an evaluation of:
 - Scope & content of laws, regulations & voluntary codes
 - Company practices – how widespread is adherence to standards?
 - Accessibility & effectiveness of remedies
 - Efficiency & effectiveness of regulatory supervision & enforcement

How are the OECD Principles used?

- Recognised by the Financial Stability Board as one of 12 key standards for international financial stability
- OECD Steering Group on Corporate Governance
 - Co-ordinates & guides the OECD's work on corporate governance
 - Uses the Principles & Methodology to facilitate policy dialogue in member countries (e.g. study of Corporate Governance in Turkey)
 - Uses the Principles & Methodology in its outreach work with non-member countries (e.g. Regional Corporate Governance Roundtables, country reviews)
- OECD Principles are used in World Bank assessments under its ROSC programme
- As inspiration to local governance codes (i.e. Moroccan corporate governance code)
- Principles and Methodology can be used by policy makers, international organisations & private associations (e.g. directors' institutes) to assess corporate governance standards & practices



OECD and the Financial Crisis

OECD response to emerging CG challenges

- Overview of the international “regulatory” framework in corporate governance; main actors and the use of the OECD Principles. Report highlighting main weaknesses and how to improve monitoring and implementation.
- Global Consultation and co-operation with other international organisations, non-member countries, business and stakeholders.
- Progress reports to the FSB meetings and collaboration with the Basel Committee. Reports to the G20 meetings.
- Mandate to undertake thematic peer reviews from the OECD Steering Group on Corporate Governance. Developing concept.

OECD's thinking on the role of corporate governance in the crisis

- Corporate governance lessons from the financial crisis, November 2008
- Corporate Governance and Temporary Government Control over Financial Institutions, November 2008
- Corporate Governance and the Financial Crisis: Key findings and main messages, April 2009
- The turmoil and the financial industry: banking in a post-crisis landscape, April 2009

OECD Strategic Response to the Financial and Economic Crisis

CONTRIBUTIONS TO THE GLOBAL EFFORT



The Corporate Governance Lessons from the Financial Crisis

Grant Kirkpatrick*

This report analyses the impact of failures and weaknesses in corporate governance on the financial crisis, including risk management systems and executive salaries. It concludes that the financial crisis can be to an important extent attributed to failures and weaknesses in corporate governance arrangements which did not serve their purpose to safeguard against excessive risk taking in a number of financial services companies. Accounting standards and regulatory requirements have also proved insufficient in some areas. Last but not least, remuneration systems have in a number of cases not been closely related to the strategy and risk appetite of the company and its longer term interests. The article also suggests that the importance of qualified board oversight and robust risk management is not limited to financial institutions. The remuneration of boards and senior management also remains a highly controversial issue in many OECD countries. The current turmoil suggests a need for the OECD to re-examine the adequacy of its corporate governance principles in these key areas.

* This report is published on the responsibility of the OECD Steering Group on Corporate Governance which agreed the report on 13 February 2009. The Secretariat's draft report was prepared for the Steering Group by Grant Kirkpatrick under the supervision of Mats Johanson.

Risk management: accepted by all, but poor track record...

- OECD CG Principle VI.D. *the board should be monitoring the company's management practices and making changes as needed*
- Focus on CG of risk management, not technical calculations
- Risk models used by f/s failed due to technical assumptions
- Internal controls (SOX 404) only subset of risk management, broader context did not get attention
- Stress testing has shown deficiencies, not consistent or comprehensive ; transmission of information failed in some cases
- Senior Supervisors Group report (2008)
- Management of better performing firms had more active controls over the consolidated balance sheet

Risk policy is a duty of the board, but are they up to the task?

- OECD CG Principle VI.C.: *the board should fulfill certain key functions including reviewing and guiding corporate strategy, major plans of action, risk policy...and ensuring that appropriate systems of control are in place »*
- Boards have been quite active, CEOs at problem banks replaced
- Knowledge about risk management methodology lacking
- Board composition— banks report difficulties in recruiting non-executive directors
- Trade-off between independence and competence
- Reporting structures of the committees, particularly risk and audit committees

Remuneration and incentive systems: strong incentives to take risk

- OECD CG Principle VI.3: *the board should align key executive and board remuneration with the long term interests of the company and its shareholders*
- Was link between performance and pay compromised ?
- Executive remuneration subject to little analysis
- Concern that incentive systems led to short termism and «reward failure »; large parting payments to CEOs (Citibank, 100 mil, Merrill Lynch, 160 mil USD)
- Only a few European banks disclosed remuneration policies
- Remuneration problems at the sales and trading function level; bonuses without formal account of earnings sustainability
- Recent initiatives to re-regulate pay.

OECD Recommendations to G20 meeting: (April 2009)

- Strengthen “fit and proper” person test to cover competence, technical expertise, etc.; extend it to cover more institutions, etc.
- Formal separation of CEO and Chair; term limit on board membership.
- Risk officer role with access to the board (not necessarily a Risk Committee but preferably not Audit Committee) . CEO doesn't fire or set salary.
- Fiduciary responsibility of directors: need to clarify in large and complex groups
- Remuneration: board reform helps, and tax incentives provide teeth.

OECD Recommendations to G20 meeting: April 2009 (cont'd)

- Long term goal should be to return nationalised banks to private ownership
- Aim for higher equity base and less leverage;
- Avoid sales to other banks instead consider private pools of equity (SWFs, pension funds, etc.)
- Decide whether and to what extent to reform governance of financial institutions prior to sell off
- During ownership phase, alter the governance arrangements in line with OECD Guidelines on Corporate governance of State-Owned Enterprises
- Three priority areas: new risk control systems, new management and new boards.



Work of the OECD in the MENA Region

How is OECD work relevant to the MENA region?

- Example: Policy Brief on Corporate Governance of MENA Banks
 - Risk management practices lacking and understanding of risk profile developing, CRO role not present
 - More active role of bank boards are needed, committees to be established
 - The role of supervisors in ensuring sound governance of banks essential
 - But, not all recommendations of the OECD relevant to MENA (i.e. executive compensation practices different)
- Policy brief available upon request

Recent and upcoming OECD meetings on CG in the MENA region

- October 11, 2009 – Regional Taskforce on CG of Banks
 - Invited Central Banks' and banking associations' representatives
 - Receive and review recommendations of the Policy Brief on Corporate Governance of Banks
- November 9-10, 2009 – Regional OECD-Hawkamah Annual Meeting
 - Address a variety of topics (cg of banks, cg of SOEs, the role of stock exchanges in cg)
 - Decisions on next projects to be taken by Working Group participants
- OECD participation in national events
 - Conferences organised of the EIOD, ACGC, etc.



Refer to www.oecd.org/daf/corporate-affairs
for more information

Thank you!

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