

Corporate Governance – Global Governance Initiatives*

What is Corporate Governance

The phrase “Corporate Governance” describes “the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled within corporations. It encompasses the mechanisms by which companies, and those in control, are held to account.”

Corporate governance means to steer an organization in the desired direction by determining ways to take effective strategic decisions. It also deals with the accountability of the individuals through a mechanism which reduces the principal-agent problem in the organization.

Corporate Governance has a broad scope. It includes both social and institutional aspects. Corporate Governance encourages a trustworthy, moral, as well as ethical environment. In other words, the heart of corporate governance is transparency, disclosure, accountability and integrity. It is to be borne in mind that mere legislation does not ensure good governance. Good governance flows from ethical business practices even when there is no legislation.

ICSI defines the term ‘Corporate Governance’ as **“Corporate Governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders.”**

Global Initiatives

Every country is now a days is concerned about the development of corporate governance in their country. Most of the countries are issuing the Corporate Governance Guidelines from time to time for the guidance of the Corporates. Some recent developments in the field of Corporate Governance are given below.

- **THE FINNISH CG CODE 2020**

The new Corporate Governance Code for Finnish listed companies (“2020 CG Code”) entered into force from 01 January 2020 replacing the previous CG Code applied since 2016 (“2015 CG Code”). The purpose of the Corporate Governance Code is to harmonise the procedures of listed companies and to promote openness with regard to corporate governance and remuneration. From the perspective of a shareholder and an investor, the Corporate Governance Code increases the transparency of corporate governance and the ability of shareholders and investors to evaluate the practices applied by individual companies. The Corporate Governance Code also provides investors with an overview of the kinds of corporate governance practices that are acceptable for Finnish listed companies.

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Views expressed in the Article may not express the views of the Institute.

While the number of recommendations in the 2020 CG Code has decreased, the 2020 CG Code introduces additional requirements on listed companies, in particular in relation to remuneration and related party transactions as required by the Shareholders' Rights Directive and the national rules implementing the Directive. The 2020 CG Code also introduces changes to the recommendation concerning the audit committee and clarifications to the recommendation concerning the assessment and disclosure of independence of board members. For example, the company's remuneration statement has been replaced by the remuneration policy for governing bodies ("remuneration policy") and remuneration report for governing bodies ("remuneration report"), which are supplemented by information provided on the company's website. The remuneration policy and report concern the company's board of directors, supervisory board, if any, and the managing director and deputy managing director. Information on the remuneration of the rest of the management team will in future be provided on the company's website. The remuneration reporting section also includes a checklist to clarify the reporting obligations. Similarly, the board must in future report which of the board members are independent of the company and which are independent of the company's significant shareholders. In addition, the reasoning for determining that a board member is not independent must also be reported. The criteria to be taken into account in the overall assessment of independence have also been supplemented so that under the interpretation of the criteria, the benefits paid and offered to a member of the board by a shareholder otherwise than on the basis of an employment or service relationship may require assessment.

The Finnish Securities Market Association's board adopted the amended and updated CG Code in September 2019. As a result of which the new 2020 CG Code came into force in January 2020 replacing the previous Finnish CG Code.

The 'comply or explain' principle applies to the CG Code. Thus, the starting point is that the company must comply with all recommendations set out in the CG Code.

Sources:

<https://www.borenius.com/2020/02/28/new-corporate-governance-code-for-finnish-listed-companies-what-actions-are-required/>

<https://cgfinland.fi/en/corporate-governance-code/>

<https://cgfinland.fi/wp-content/uploads/sites/39/2019/11/corporate-governance-code-2020.pdf>

- **Principles for Responsible Institutional Investors - Japan's Stewardship Code**

In this Code, "stewardship responsibilities" refers to the responsibilities of institutional investors to enhance the medium- to long-term investment return for their clients and beneficiaries (including ultimate beneficiaries; the same shall apply hereafter) by improving and fostering the investee companies' corporate value and sustainable growth through constructive engagement, or purposeful dialogue, based on in-depth knowledge of the companies and their business environment and consideration of sustainability (medium- to long-term sustainability including ESG factors) consistent with their investment management strategies.

This Code defines principles considered to be helpful for institutional investors who behave as responsible institutional investors in fulfilling their stewardship responsibilities with due regard both to their clients and beneficiaries and to investee companies. By fulfilling their stewardship responsibilities properly in line with this Code, institutional investors will also be able to contribute to the growth of the economy as a whole.

Activities by institutional investors done to discharge their stewardship responsibilities (hereafter, “stewardship activities”) should not be seen to be confined to voting, although voting is an essential element of stewardship activities. Stewardship activities include proper monitoring of the investee companies and constructive engagement with them done to discharge the stewardship responsibilities to foster sustainable growth of the companies

In the Code, two categories of institutional investors are identified: “institutional investors as asset managers” (hereafter, “asset managers”), which are entrusted to manage funds and invest in companies; and “institutional investors as asset owners” (hereafter, “asset owners”), including providers of funds.

The asset managers are expected to contribute to the enhancement of the corporate value of investee companies through day-to-day constructive dialogue with them.

The asset owners are expected to disclose their policies on fulfilling their stewardship responsibilities and contribute to the enhancement of the corporate value of investee companies through their own actions and/or the actions of the asset managers, to which they outsource their asset management activities.

The asset managers should aim to know the intention of the asset owners so that they can provide services as expected, and the asset owners should aim to assess the asset managers in line with the Code, not placing undue emphasis on short-term performance.

Parties such as proxy advisors and investment consultants for pensions which provide services at the request of institutional investors, etc. to contribute to the institutional investors’ effective execution of stewardship activities (hereafter “service providers for institutional investors”) are expected to play important roles in enhancing the functions of the entire investment chain running from their clients and beneficiaries to the investee companies. Principle 8 of the Code specifically applies to service providers for institutional investors.

Source : <https://ecgi.global/node/8065>

- **Italian Corporate Governance Code**

The Italian Corporate Governance Code (“Code”) applies to all companies with shares listed on the Italian main market (“Mercato Telematico Azionario”, hereinafter “MTA”) managed by Borsa Italiana (“companies”).

Adoption of this Code is voluntary and is disclosed in the report on corporate governance and ownership structures (“corporate governance report”).

The code has 6 articles and each article of the Code is divided into principles, which define the objectives of good governance, and into recommendations, which indicate the behaviour that the Code deems appropriate to achieve the objectives indicated in the principles.

The Code is neutral with respect to the governance model specifically adopted by the company (traditional; "one-tier", which includes the so-called "modello monistico" for Italian companies; "two-tier", which includes the so-called "modello dualistico" for Italian companies). For companies adopting the "two-tier" model, the Code requires that the supervisory board is to be assigned the task of deliberating on the company's strategic guidelines and transactions of strategic importance (so-called "high level" management powers).

Companies apply the Code according to the principle of substance over form and the recommendations thereof on a "comply or explain" basis.

Companies adopting the Code provide in their corporate governance report accurate, easily understandable and exhaustive, albeit concise, information on how the Code is

The application of the Code is based on principles of flexibility and proportionality.

Companies disclose in their corporate governance report how they have specifically applied the Code's principles. The choice to depart from one or more recommendations of the Code may depend on factors internal and external to the company, whereby the practice recommended by the Code may not be functional or compatible with its governance model. The application of the Code implies, however, that each deviation is clearly indicated in the corporate governance report and that companies:

- (a) explain how the best practice recommended by the Code has been disregarded;
- (b) describe the reasons for the deviation;
- (c) describe how the decision to depart from the recommendations has been made within the company;
- (d) if the deviation is limited in time, indicate when they plan to apply the related best practice;
- (e) describe any action adopted as an alternative to the best practice which they have not implemented and explain how this choice helps the company achieving the objective underlying the Code's principles and in any case contributes to good corporate governance.

In order to ensure a proportional application of the Code, some recommendations are calibrated according to the company's size and ownership structure, providing for:

- a set of recommendations intended only for larger companies ("large companies" category contained in the Code's "definitions");
- a simplified application of some recommendations by companies other than the "large" ones;
- the adaptation of some recommendations to companies with concentrated ownership (cf. the category of "companies with concentrated ownership" contained in the Code's "definitions").

In the presence of primary or secondary regulations incompatible with the application of certain recommendations of the Code, disclosure of the reasons for their failed or partial application is not required.

The Committee monitors the state of the Code's application, the evolution of the applicable regulatory framework and the international best practices, and is responsible for updating the Code. To this end, it evaluates a possible revision of the Code usually every two years.

The application of the Code is facilitated by a set of Q&As, periodically updated also in consideration of any requests that might be submitted by those companies that apply the Code.

The present Code was approved by the Committee in January 2020.

The companies adopting the Code are required to apply it starting from the first financial year that begins after 31 December 2020, while the disclosure shall be provided in the corporate governance report to be published during 2022.

"Large companies" apply the recommendations regarding the presence of independent directors in the board of directors starting from the first renewal of the board of directors following 31 December 2020.

Source : https://ecgi.global/sites/default/files/codes/documents/2020code_eng.pdf

- **OECD Publishes the Report on Corporate Governance in Costa Rica that will Improve the Country's Management Strategies**

The Organization for Economic Cooperation and Development (OECD) published the report: "Corporate Governance in Costa Rica". This review of Corporate Governance in Costa Rica was prepared as part of Costa Rica's accession process for OECD membership.

During the three-year period of the review, the government made substantial progress in strengthening its institutional and legal framework in line with the G20/OECD Principles of Corporate Governance and OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOEs). Regarding Costa Rica's implementation of the *G20/OECD Principles*, Costa Rica's greatest challenge relates to the development of a more active capital market with a larger number of actively traded companies.

The report evaluates Costa Rica's corporate governance policies and practices for both listed and state-owned companies.

It finds that while Costa Rica's capital market is quite small, its framework for corporate governance of listed companies is largely consistent with the Principles. Costa Rica has seen particular progress in issuing a new corporate governance code and requirements related to ownership disclosure. For SOEs, which play a key role in the Costa Rican economy, the Presidency has taken important steps to establish a co-ordinating unit which has spearheaded numerous reforms.

These reforms include issuing a government ownership policy, more transparent and structured appointments of SOE board members (while removing politicians from boards), and reporting on SOEs' performance. To further strengthen SOE performance and accountability, the report recommends additional steps to improve board practices, clarify performance objectives and implement International Financial Reporting Standards.

The securities supervisor (SUGEVAL) and listed companies have co-operated in developing proportional approaches to implementing Costa Rica's new Corporate Governance Regulation, which is having a positive impact on governance practices. The regulation is modelled after OECD practice and is being implemented using a risk-based supervisory approach.

While Costa Rica has also made substantial progress in implementing recommendations of the *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, considerable challenges remain to further align practices with the *SOE Guidelines'* recommendations. The following priority recommendations are therefore addressed to Costa Rica:

- **Fully implement IFRS.** Costa Rica has defined IFRS as the reporting standard for SOEs. Governance scandals, fiscal reforms, pressure from lenders and international organisations have encouraged a greater commitment to IFRS. It is recommended that Costa Rica's government ensure full implementation and compliance with IFRS without further delays to current legal and regulatory requirements.
- **Develop and implement a system for establishing and monitoring the achievement of financial and non-financial performance objectives.** Costa Rica's ownership policy envisages that performance targets will be set via a "note of expectations" sent from the Government Executive to SOEs, which will establish goals and indicators for what the state deems important to achieve. The implementation of this system for setting performance objectives should allow for far better monitoring of SOEs. Achieving this will require sufficient resources and a continued strengthening of the Presidential Advisory Unit's capacity.
- **Develop a consistently applied policy regarding information confidentiality.** Presidential decrees have been adopted that call for greater transparency amongst SOEs that circumscribe the right to withhold confidential information. However, these decrees do not define in detail what information is confidential and what is not, which has led to differing interpretations. Costa Rica allows SOEs to develop their own confidentiality policies, thus opening the door for a heterogeneity of approaches. It is recommended that a clarification occur at central level followed by active monitoring and enforcement to ensure consistent application of confidentiality policies in line with best practices.
- **Enact legislation to remove the Minister of Agriculture from the board overseeing FANAL.** The government has introduced a draft bill to the Legislative Assembly that would remove the Minister of Agriculture from the board of directors of the National Production Council, the parent body whose board currently takes decisions on behalf of its subsidiary SOE, the national liquor production company FANAL. The government has also announced its intention to re-structure and/or privatise these entities. In the event that the government decides to retain FANAL as an SOE, it should ultimately establish a separate board of directors for FANAL.
- **Pursue public procurement reforms to monitor and limit the use of exceptions for direct public procurement between public entities including SOEs.** Costa Rica plans to enact a comprehensive reform of the Procurement Law and aims to achieve greater efficiency and competition in all public procurement procedures. The draft laws would reduce the number of exceptions to ordinary procurement procedures and introduce new requirements for their use.
- **Make further progress on implementing initiatives to strengthen the functioning of boards, including the implementation of board evaluations, and effective risk management and control systems.** SOE boards continue to need board members with greater private sector, financial, international and business expertise and knowledge of best practices in SOE governance. An important step in developing stronger boards is to

conduct board self-evaluations mandated by law, analyse them at central level and develop remedial action plans. Further, boards need to act on their responsibility under best practice to ensure an effective control environment including one that monitors and manages risks associated with conflicts of interest and corruption. The establishment of audit committees may assist in this regard.

- **Review SOE board remuneration and develop recommendations to support competitive remuneration and incentives that are aligned with good board practices.** A research study was being conducted on remuneration practices in the public sector in co-operation with the Inter-American Development Bank and MIDEPLAN. That study has the objective of establishing a fee scale for SOE boards using labour market data from the public and private sector as reference. The study was expected to be completed by July 2020.

The Committee and Working Party also address the following additional recommendations to Costa Rica concerning implementation of the *SOE Guidelines*:

- **Corporatisation and other streamlining of SOE legal and corporate forms.** Costa Rican SOEs are established and operate under a complex web of laws. These laws should be simplified and made more uniform. One of the principal recommendations in the accession review was to use the legal structure of a public limited company (Plc) for SOEs, which would simplify adaptation of SOE governance to best practice.
- **Consider further reforms to strengthen boards, including staggering of board appointments and separation of the role of Chair and CEO.** At present, the law requires that a significant portion of board members be appointed virtually immediately after an administration comes to power, making the process rushed and possibly working to the detriment of finding the best available board talent. A change in law that would allow existing board members to stay on until a proper process can be completed would be desirable. Further, Costa Rica should work towards removing the possibility for a board Chair to simultaneously exercise the powers of CEO.
- **Continue to work towards a more level playing field, particularly in the banking sector through enactment of deposit insurance reform.** At the time of the Corporate Governance Committee's final review of Costa Rica in October, 2019, the government had submitted a draft bill to the Legislative Assembly to create a deposit insurance and bank resolution scheme applying to both state-owned and private sector banks. The legislation has subsequently been enacted in February, 2020.
- **Defining, reporting and assessing the costs of public service objectives for each SOE.** The financial statements and internal budgets of Costa Rican SOEs do not generally break out the portion of revenues and costs that are associated with the provision of public services and feedback from SOEs suggests that the costs of policy commitments are not fully recognised. Efforts should be put into better defining public service costs and ensuring that they are fully compensated.

Sources:

https://read.oecd-ilibrary.org/governance/corporate-governance-in-costa-rica_b313ec37-en#page14

<https://www.oecd-ilibrary.org/sites/b313ec37-en/1/3/5/index.html?itemId=/content/publication/b313ec37->

en&_csp_ee9edb1878c65fe5c9bbe251d7379181&itemIGO=oeed&itemContentType=book

- **ICGN Global Stewardship Principles: 2020 revisions**

The ICGN Global Stewardship Principles (Principles) set out ICGN's view of current best practices in relation to investor stewardship obligations, policies, and processes. These Principles provide a framework to implement stewardship practices in fulfilling an investor's fiduciary obligations to beneficiaries or clients.

Main changes from the 2016 Principles:

While ICGN believes the Principles remain robust and fit for purpose, specific changes or additions have been made to reflect changes in market practice and regulation. The main changes include:

- More emphasis on fiduciary duty, culture, and values by institutional investors. Good stewardship requires not only policies and processes, but it is essential that investors embrace its underlying principles and adapt these within their organisations.
- An explicit link between fiduciary duty and long-term value creation, which is in turn directly linked to sustainable benefits for the economy, environment, and society. Particularly for investors whose beneficiaries are pensioners and individuals saving for retirement, a long-term perspective is fundamental to stewardship. In turn, sustainable value creation for long-term savers is a social good with broad social and economic benefits.
- The use of ESG factors in investment decision making, as well as stewardship. ESG factors are clearly linked to long term company performance and should be considered not only in the context of engagement and voting, but also in investment decisions relating to valuation and the buying or selling of financial assets.
- Greater focus on systemic risks relevant to institutional investors. It is important for investors to recognise that systemic risks, including those relating to climate change, wealth inequality and anti-corruption, can affect the sustainable value creation of individual companies as well as the health of economies and financial markets.
- More emphasis on the application of stewardship to asset classes beyond listed equities. Institutional investors invest in a wide range of assets on behalf of their beneficiaries. While listed equities are a logical starting point, reflecting investor ownership rights, the broad principles of stewardship are relevant to other classes, including corporate and public sector debt, private equity, real estate, and infrastructure.
- Identifying capital allocation as an important topic for engagement for both creditors and shareholders. Sustainable companies must recognise and respect the different requirements of both providers of corporate capital. Creditors generally seek a stable and predictable credit risk profile and shareholders have a focus on upside potential and risk adjusted returns on capital.
- Protecting voting rights against dual class shares and other forms of differential ownership which have the practical effect of marginalising stewardship and the

accountability of companies to minority shareholders by diluting their voting rights. This stands in sharp contrast to the ambition of stewardship to empower shareholders, through voting and engaging, to exercise their voice in direct proportion to their economic stake in a company.

- Encouraging investors to disclose more information about stewardship activities and outcomes. Stewardship has the greatest meaning when it is directly relates to practical outcomes, and not just a policy framework. Beneficiaries should have a clear understanding as to how stewardship provides meaningful benefits.

ICGN Global Stewardship Principles:

Principle 1:

Internal governance: the foundation of effective stewardship

Investors should keep under review their own governance practices to ensure consistency with the aims of national requirements and the ICGN Global Stewardship Principles and their ability to serve as fiduciary agents for their beneficiaries or clients.

Principle 2:

Developing and implementing stewardship policies

Investors should develop and implement stewardship policies which outline the scope of their responsible investment practices.

Principle 3:

Monitoring and assessing investee companies

Investors should exercise diligence in monitoring companies held in investment portfolios and in assessing new companies for investment.

Principle 4:

Engaging companies and investor collaboration

Investors should engage with investee companies with the aim of preserving or enhancing value on behalf of beneficiaries or clients and should be prepared to collaborate with other investors to enhance engagement outcomes.

Principle 5:

Exercising and protecting voting rights

Investors with voting rights should seek to vote shares held and make informed and independent voting decisions, applying due care, diligence, and judgement across their entire portfolio in the interests of beneficiaries or clients.

Principle 6:**Promoting long-term value creation and integration of environmental, social and governance (ESG) factors**

Investors should promote the long-term performance and sustainable success of companies and should integrate material environmental, social and governance (ESG) factors in investment decision-making and stewardship activities.

Principle 7:**Meaningful transparency, disclosure and reporting**

Investors should publicly disclose their stewardship policies and activities and report to beneficiaries or clients on how they have been implemented so as to be fully accountable for the effective delivery of their duties.

Sources:

https://www.icgn.org/sites/default/files/ICGN%20Global%20Stewardship%20Principles%202020_0.pdf

Conclusion

Good corporate governance promotes investor confidence, which is crucial to the ability of entities listed on stock exchanges to compete for capital. Good corporate governance is essential to develop additional values to the stakeholders as it ensures transparency which ensures strong and balanced economic development. This also ensures that the interests of all shareholders (majority as well as minority shareholders) are safeguarded. It ensures that all shareholders fully exercise their rights and that the organization fully recognizes their rights. Every country understands the significance of the Corporate Governance and this is the main reason why the Countries issues the guidelines for the guidance of the corporates towards Corporate Governance.
