Review of the OECD Principles[*]

The OECD Principles of Corporate Governance were finalized and agreed in May of 1999. The Asian financial crises had shown that poor corporate governance underlies macroeconomic instability and banking failures. This prompted a number of initiatives, including the creation of the Financial Stability Forum that in turn developed the "Compendium of [Financial and Economic Policy Codes and] Standards."

- Twelve standards were identified as "key," including four relating to institutional and market infrastructure – in accounting, auditing, corporate governance and insolvency.

- The OECD Principles aim at improving the legal, institutional and regulatory framework for corporate governance in OECD and non-OECD countries.

As many of you are well familiar, they are organized into five parts addressing:

- Rights of shareholders;
- Equitable treatment of shareholders;
- The role of stakeholders;
- Disclosure and transparency; and
- Responsibilities of the Board.

The Principles were scheduled to be revisited in 2005…. However, if bursting of dot.com and telecom bubbles signaled concerns, then Enron (which prompted the President to pronounce his Ten Point Plan) and subsequent accounting scandals at WorldCom (which hastened the passage of what was to become the Sarbanes-Oxley Act) resulted in calls for action.

In the spring of 2002, OECD leadership wanted to be more proactive in addressing concerns raised by growing number of corporate failures, including failures in governance. Ministers agreed in April to move the assessment of the Principles forward by one year (to 2004) and to survey recent developments in Member countries since the development of the Principles

The Ministers' mandate was clear: to survey developments and assess the Principles – not to re-write or revise or to toss them out and start over. There subsequently have been calls to strengthen the OECD Principles – to make them stronger, more explicit, or more binding.

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[*] Presented by Sherman G. Boone, Senior International Economist, Office of International Banking & Securities Markets, U.S. Department of the Treasury, at the Fourth Meeting of the Latin American Corporate Governance Roundtable in Santiago, Chile, 28 May 2003. The views presented herein do not necessarily represent those of the U.S. Department of the Treasury.

Last October, the Financial Stability Forum hosted a special session that mapped the various work programs in major financial centers and, globally, through the international financial institutions and regulatory bodies.

In mid-November, the OECD Secretary General hosted an informal meeting "to see what scope there is for consensus on a revised and tougher code." Reports suggested that the code is no longer sufficient and could be revised to:

- Include detailed recommendations covering the role of lawyers, financial analysts and credit rating agencies;

- Provide for a more active and disclosed role for institutional investors, and governance of and by financial institutions with fiduciary responsibilities;

- Promote greater transparency of corporate structures;

- Define "independence" in the context of boards of directors, audit committees; and

- Address state-owned companies and government-managed corporate assets.

I do think it important to revisit the Principles. But in doing so, it is also important to remember that they are preceded by a Preamble that sets out the rationale for developing the Principles as well as their aims. Recall that they are:

- Intended to assist member and non-Member governments in their efforts to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their countries; and

- To provide guidance and suggestions for stock exchanges, investors, corporations and other parties that have a role in the process of developing good corporate governance.

- They are not intended to substitute for private sector initiatives to develop more detailed "best practices" in governance.

- The Principles are non-binding and do not aim at detailed prescriptions for national legislatures. Their purpose is to serve as a reference point. They can be used by policy makers, as they examine and develop their legal and regulatory frameworks for corporate governance that reflect their own economic, social, legal and cultural circumstances, and by market participants as they develop their own practices.

- The Principles are evolutionary in nature and should be revised in light of significant changes in circumstances.

Arguably, recent highly publicized instances of corporate abuse – in governance, accounting and auditing – set the stage for <u>accelerating</u> this review. But we do not see

these very prominent episodes as evidencing the need to completely revamp either the form or the substance of the Principles.

Obviously, some re-tuning of some elements is needed, based on the "lessons learned" over the past eighteen months of scandals during the short history of the Principles and outreach to non-OECD countries.

However, giving the Principles a close look, it is not clear that they are "out-of-touch" or out of date. The major issues as defined clearly resonate today:

- **Rights of shareholders and equitable treatment of shareholders** obviously go to the heart of the recent collapse of market confidence. This "constituency" is more broadly defined today than perhaps envisaged by some in 1998/99, and now clearly includes employee-owners with retirement accounts tied to shares.

- **"Stakeholders"** may also be more broadly defined today, including creditors and others with a direct interest in the on-going viability of the corporation.

- Many changes in the realm of **transparency and disclosure** have recently been set in train – internationally through IOSCO, and in the U.S. under the Sarbanes-Oxley Act – relating to accounting standards and auditor oversight and independence.

- **Management responsibilities** and **the role of the Board** are a key element of Sarbanes-Oxley and other sets of private sector recommendations. The goal is to promote boards as representatives of shareholders' (and broader company) interests, not just tools for management.

Going forward, others may see a place for more "prescriptive" Principles, defining what are "best practices." Still others may wish to revisit old battlegrounds, especially regarding the role of stakeholders, but this thinking is terribly out-of-date given the widening base of shareholders and their increasing activism.

In this light, I believe that the March meetings of the OECD Corporate Governance Steering Group went far more smoothly than some might have anticipated. This meeting was preceded by a day of consultations with representatives from labor and industry. Following these consultations and an initial overview of the existing Principles, the Group agreed that it will not reopen the Principles – which will remain principles – and not try to make them more directive or prescriptive.

I anticipate that there will be some changes, and the accompanying Annotations will be elaborated to reflect lessons from recent corporate failures, subsequent changes in "best practice" and the experiences of trying to pursue and assess implementation of the Principles in various OECD Member and Non-Member countries.

- The Steering Group will not aim to get into the specifics of the on-going reforms of accounting and auditing standards, or rules for corporate disclosure, leaving these to other expert bodies.

- To counter more prescriptive suggestions regarding executive compensation, the Group ultimately may recommend a new "management" chapter (taking the CEO issues out of the current chapter on the Board).

- The Group is also wrestling with how to deal with service providers (lawyers, credit rating agencies and analysts) without reaching conclusion, but we should be able to devise something generally acceptable.

- We also agree that other OECD work relating to corporate governance of financial institutions and fiduciaries would be subservient to the Principles.

The Financial Stability Forum call to make the Principles "more demanding" was certainly heard. But there was little support from those involved in consultations or Steering Group Members to expand the breadth of the Principles too far (notwithstanding industry-specific guidance that may be developed consistent with the Principles), and even less to move too deeply (given wide differences in corporate law and regulation among Members and Non-members).

The Group did agree that more guidance might be helpful on implementation and enforcement issues, but this would have to be by way of example in the Annotations, rather than additional Principles. Indeed, a closer examination of the existing Principles does not suggest that the weakness was with the guidance provided -- though this guidance can be improved in light of recent experience and lessons learned -- but with slack implementation and/or enforcement of laws, regulations or rules consistent with the Principles.

The Steering Group will reconvene in two weeks to finalize the survey of recent developments in OECD Members, consider preliminary inputs from the various regional Roundtables and begin to scope the expanded Annotations. We subsequently will meet again in early November for consultations with Non-member Governments (organized through the Global Corporate Governance Forum) and perhaps further discussions with business and labor representatives.

The (Australian) Chair aims to finish the project next spring, and this does appear achievable given early consensus on many issues.

In the meantime, the Leaders of Eight major industrialized democracies will meet this coming week-end in Evian, France. President Chirac has called on the G-8 to take up the theme of responsible market economy. His vision, as initially laid out, rested on two pillars -- of corporate governance and corporate social responsibility. This agenda has been refined over the past months, to include anti-corruption and fiscal transparency.

Focus on these areas will be evident in the coming days as Leaders seek to restore investor confidence and promote growth and prosperity around the globe.

In conclusion, our aim in reviewing the OECD Principles of Corporate Governance is to raise the bar … and to keep it moving upward over time. This is an evolutionary process. We will learn from our successes, as well as from failures, and the inputs from discussions such as we are having here over the next several days.

But the evidence thus far suggests that a market-oriented, investor-centric approach to corporate governance is most successful in delivering the greatest value at the least cost to the economy and – despite recent (and notable) failures, the busting asset bubble and a "geopolitical situation" charged with uncertainty – I would say that the original drafters did a very good job in framing the Principles to guide on-going improvements in corporate governance.

Thank you.