ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

OECD Principles of Corporate Governance

OECD

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Pursuant to Article 1 of the Convention signed in Paris on 14th December 1960, and which came into force on 30th September 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

– to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;

– to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and

– to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

The original Member countries of the OECD are Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The following countries became Members subsequently through accession at the dates indicated hereafter: Japan (28th April 1964), Finland (28th January 1969), Australia (7th June 1971), New Zealand (29th May 1973), Mexico (18th May 1994), the Czech Republic (21st December 1995), Hungary (7th May 1996), Poland (22nd November 1996) and Korea (12th December 1996). The Commission of the European Communities takes part in the work of the OECD (Article 13 of the OECD Convention).

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OECD PRINCIPLES OF CORPORATE GOVERNANCE

The OECD Council, meeting at Ministerial level on 27-28 April 1998, called upon the OECD to develop, in conjunction with national governments, other relevant international organisations and the private sector, a set of corporate governance standards and guidelines. In order to fulfil this objective, the OECD established the Ad-Hoc Task Force on Corporate Governance to develop non-binding principles that embody the views of Member countries on this issue.

The Principles contained in this document build upon experiences from national initiatives in Member countries and previous work carried out within the OECD, including that of the OECD Business Sector Advisory Group on Corporate Governance. During their preparation, a number of OECD committees also were involved: the Committee on Financial Markets, the Committee on International Investment and Multinational Enterprises, the Industry Committee, and the Environment Policy Committee. They also benefited from broad exposure to input from non-OECD countries, the World Bank, the International Monetary Fund, the business sector, investors, trade unions, and other interested parties.

The Principles were endorsed by Ministers at the OECD Council meeting at Ministerial level on 26-27 May 1999.

TABLE OF CONTENTS

PREFACE

Over the past decade, the world has witnessed a significant transformation in the role of the private sector in economic development and job creation. As more and more countries have adopted market-based approaches to economic policy, awareness of the importance of private corporations for the welfare of individuals has increased.

Corporations create jobs, generate tax income, produce a wide array of goods and services at reasonable prices, and increasingly manage our savings and secure our retirement income. Amid growing reliance world wide on the private sector, the issue of corporate governance has similarly risen in prominence.

This has been true for a number of years within OECD countries, where a great deal of work has taken place to improve corporate governance regimes. The recent financial crises in Asia and elsewhere also have made amply clear to other countries around the world why the issues of transparency and accountability in corporate governance are so important to investor confidence and to overall national economic performance. Corporate governance relates to the internal means by which corporations are operated and controlled. While governments play a central role in shaping the legal, institutional and regulatory climate within which individual corporate governance systems are developed, the main responsibility lies with the private sector.

A good corporate governance regime helps to assure that corporations use their capital efficiently. Good corporate governance helps, too, to ensure that corporations take into account the interests of a wide range of constituencies, as well as of the communities within which they operate, and that their boards are accountable to the company and the shareholders. This, in turn, helps to assure that corporations operate for the benefit of society as a whole. It helps to maintain the confidence of investors – both foreign and domestic – and to attract more "patient", long-term capital.

In response to growing awareness of the importance of good corporate governance, the OECD was asked by Ministers in 1998 to develop a set of standards and guidelines for presentation to Ministers by May 1999.[1] These Principles respond to that mandate. They were endorsed by Ministers at the OECD Council meeting at Ministerial level on 26-27 May 1999.

The OECD Principles represent the first initiative by an inter-governmental organisation to develop the core elements of a good corporate governance regime. As such, the Principles can be used as a benchmark by governments as they evaluate and improve their laws and regulations. They also can be used by private sector parties that have a role in developing corporate governance systems and best practices.

As the Preamble to this document makes clear, there is no single model of good corporate governance. Different legal systems, institutional frameworks and traditions mean that a range of different approaches have developed around the world. Common to all good corporate governance regimes, however, is a high degree of priority placed on the interests of shareholders, who place their trust in corporations to use their investment funds wisely and effectively.

In addition, the best-run corporations recognise that business ethics and corporate awareness of the environmental and societal interest of the communities in which they operate can have an impact on the reputation and long-term performance of corporations. Competitiveness and ultimate success are the result of teamwork, involving contributions from employees and other resource providers. Reflecting such considerations, the Principles recognise the role of these stakeholders and encourage active co-operation with them in creating wealth, jobs and financially sound corporations.

Although the Principles are non-binding, it ultimately is a matter of self-interest for countries and corporations to assess their own corporate governance regimes and to take these Principles to heart. In an increasingly integrated world characterised by highly mobile capital, investors' expectations for more responsive corporate governance practices are something that governments and companies cannot afford to ignore. This is not simply an issue relevant to foreign investors. Strengthening the confidence of domestic investors in a country's own corporations and stock markets matters greatly to the long-term competitiveness of corporations and to the overall health and vitality of national economies.

Because good corporate governance is a shared responsibility, the OECD welcomes and encourages the widespread use of the Principles by governments, private associations, companies, investors and other parties committed to improving corporate governance practices. The OECD looks forward to co-operating with countries within and beyond OECD Membership, with international organisations such as the World Bank and the IMF, and with regional organisations and private sector bodies in the collective effort to strengthen the fabric of corporate governance around the world.

The OECD Principles of Corporate Governance form part of a broader international effort to promote increased transparency, integrity and the rule of law. Other OECD initiatives that have contributed to this effort include the Convention on Combating Bribery in International Business Transactions, the Guidelines for Multinational Enterprises, instruments aimed at disciplining harmful tax competition and hard core cartels, the Recommendations on Improving Ethical Conduct in Public Services, and the work on the Financial Action Task Force on Money Laundering, to name just a few.

While the OECD Principles of Corporate Governance represent an important first step in developing a common international understanding of the elements of good corporate governance regimes, they are just that – a first step. Corporate governance practices are evolutionary in nature, with improvements building upon other improvements and best practices as they are developed. These Principles also must be evolutionary. It is the intention of the OECD to continue its analysis of issues relevant to corporate governance, to stay abreast of developments around the world, and to review and possibly revise these Principles in light of changing circumstances.

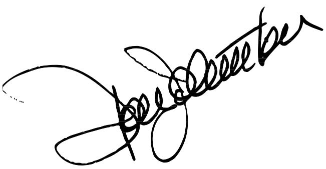
We extend our sincere appreciation to members of the Ad-Hoc Task Force, whose dedication and expertise made it possible to develop these Principles in a remarkably short period of time.[2] The co-operative and constructive manner in which all participants approached this effort made it possible to bring it to a successful conclusion. We also thank all those organisations and individuals who participated in our consultations or submitted comments as well as the many OECD delegates to four committees which were involved: the Committee on Financial Markets, the Committee on International Investment and Multinational Enterprises, the Industry Committee, and the Environment Policy Committee. Your input contributed greatly to the success of the effort and to making these OECD Principles of Corporate Governance a relevant and living document.

The Principles also benefited greatly from input by representatives of non-OECD countries on several continents, as well as from a wide array of private sector representatives and other interested parties. Finally, successive drafts of the Principles were posted on the OECD's website, making it possible for a broader segment of the public to comment.

The Principles build upon experiences in OECD Member countries and previous work conducted within the OECD. In this regard, the 1998 Report to the OECD by the Business Sector Advisory Group on Corporate Governance played an important role. A copy of these Principles and related material can be found on the OECD's website at: http://www.oecd.org/daf/governance/principles/htm.

Donald J. Johnston

Secretary-General



Joanna R. Shelton

Deputy Secretary-General
Chairman, OECD Ad-Hoc
Task Force on Corporate Governance

Notes

1. To fulfil the Ministerial mandate, the OECD established an Ad-Hoc Task Force, comprised of all Member governments; the European Commission; four international organisations (the World Bank, International Monetary Fund, Basle Committee on Banking Supervision, and the International Organisation of Securities Commissions); the OECD's Business and Industry Advisory Committee (BIAC) and Trade Union Advisory Committee (TUAC); and representatives from selected other private sector organisations.
2. We would also like to thank the OECD Secretariat staff who devoted long hours to serve the Task Force with dedication and excellence: in the *Directorate for Financial, Fiscal and Enterprise Affairs*: William Witherell, Rainer Geiger, John Thompson, Mats Isaksson, Richard Frederick, Stilpon Nestor, Elisabeth Wilson-Smith; in the *Directorate for Science, Technology and Industry*: Maria Maher; and in the *General Secretariat*: Tony Rottier and Pierre Poret.

PREAMBLE

The Principles 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. The Principles focus on publicly traded companies. However, to the extent they are deemed applicable, they might also be a useful tool to improve corporate governance in non-traded companies, for example, privately held and state-owned enterprises. The Principles represent a common basis that OECD Member countries consider essential for the development of good governance practice. They are intended to be concise, understandable and accessible to the international community. They are not intended to substitute for private sector initiatives to develop more detailed "best practice" in governance.

Increasingly, the OECD and its Member governments have recognised the synergy between macroeconomic and structural policies. One key element in improving economic efficiency is corporate governance, which involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.

Corporate governance is only part of the larger economic context in which firms operate, which includes, for example, macroeconomic policies and the degree of competition in product and factor markets. The corporate governance framework also depends on the legal, regulatory, and institutional environment. In addition, factors such as business ethics and corporate awareness of the environmental and societal interests of the communities in which it operates can also have an impact on the reputation and the long-term success of a company.

While a multiplicity of factors affect the governance and decision-making processes of firms, and are important to their long-term success, the Principles focus on governance problems that result from the separation of ownership and control. Some of the other issues relevant to a company's decision-making processes, such as environmental or ethical concerns, are taken into account but are treated more explicitly in a number of other OECD instruments (including the Guidelines for Multinational Enterprises and the Convention and Recommendation on Bribery) and the instruments of other international organisations.

The degree to which corporations observe basic principles of good corporate governance is an increasingly important factor for investment decisions. Of particular relevance is the relation between corporate governance practices and the increasingly international character of investment. International flows of capital enable companies to access financing from a much larger pool of investors. If countries are to reap the full benefits of the global capital market, and if they are to attract long-term "patient" capital, corporate governance arrangements must be credible and well understood across borders. Even if corporations do not rely primarily on foreign sources of capital, adherence to good corporate governance practices will help improve the confidence of domestic investors, may reduce the cost of capital, and ultimately induce more stable sources of financing.

Corporate governance is affected by the relationships among participants in the governance system. Controlling shareholders, which may be individuals, family holdings, bloc alliances, or other corporations acting through a holding company or cross shareholdings, can significantly influence corporate behaviour. As owners of equity, institutional investors are increasingly demanding a voice in corporate governance in some markets. Individual shareholders usually do not seek to exercise governance rights but may be highly concerned about obtaining fair treatment from controlling shareholders and management. Creditors play an important role in some governance systems and have the potential to serve as external monitors over corporate performance. Employees and other stakeholders play an important role in contributing to the long-term success and performance of the corporation, while governments establish the overall institutional and legal framework for corporate governance. The role of each of these participants and their interactions vary widely among OECD countries and among non-members as well. These relationships are subject, in part, to law and regulation and, in part, to voluntary adaptation and market forces.

There is no single model of good corporate governance. At the same time, work carried out in Member countries and within the OECD has identified some common elements that underlie good corporate governance. The Principles build on these common elements and are formulated to embrace the different models that exist. For example, they do not advocate any particular board structure and the term "board" as used in this document is meant to embrace the different national models of board structures found in OECD countries. In the typical two tier system, found in some countries, "board" as used in the Principles refers to the "supervisory board" while "key executives" refers to the "management board". In systems where the unitary board is overseen by an internal auditor's board, the term "board" includes both.

The Principles are non-binding and do not aim at detailed prescriptions for national legislation. 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 reviewed in light of significant changes in circumstances. To remain competitive in a changing world, corporations must innovate and adapt their corporate governance practices so that they can meet new demands and grasp new opportunities. Similarly, governments have an important responsibility for shaping an effective regulatory framework that provides for sufficient flexibility to allow markets to function effectively and to respond to expectations of shareholders and other stakeholders. It is up to governments and market participants to decide how to apply these Principles in developing their own frameworks for corporate governance, taking into account the costs and benefits of regulation.

The following document is divided into two parts. The Principles presented in the first part of the document cover five areas: I) The rights of shareholders; II) The equitable treatment of shareholders; III) The role of stakeholders; IV) Disclosure and transparency; and V) The responsibilities of the board. Each of the sections is headed by a single Principle that appears in bold italics and is followed by a number of supporting recommendations. In the second part of the document, the Principles (which appear in bold) are supplemented by annotations that contain commentary on the Principles and are intended to help readers understand their rationale. The annotations may also contain descriptions of dominant trends and offer alternatives and examples that may be useful in making the Principles operational.

Part One

OECD PRINCIPLES OF CORPORATE GOVERNANCE

I. THE RIGHTS OF SHAREHOLDERS

The corporate governance framework should protect shareholders' rights.

A. Basic shareholder rights include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect members of the board; and 6) share in the profits of the corporation.

B. Shareholders have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, or articles of incorporation or similar governing documents of the company; 2) the authorisation of additional shares; and 3) extraordinary transactions that in effect result in the sale of the company.

C. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general shareholder meetings:

1. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.
2. Opportunity should be provided for shareholders to ask questions of the board and to place items on the agenda at general meetings, subject to reasonable limitations.
3. Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

D. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

E. Markets for corporate control should be allowed to function in an efficient and transparent manner.

1. The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.
2. Anti-take-over devices should not be used to shield management from accountability.

F. Shareholders, including institutional investors, should consider the costs and benefits of exercising their voting rights.

II. THE EQUITABLE TREATMENT OF SHAREHOLDERS

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

A. All shareholders of the same class should be treated equally.

1. Within any class, all shareholders should have the same voting rights. All investors should be able to obtain information about the voting rights attached to all classes of shares before they purchase. Any changes in voting rights should be subject to shareholder vote.
2. Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.
3. Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.

B. Insider trading and abusive self-dealing should be prohibited.

C. Members of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation.

III. THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

The corporate governance framework should recognise the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

A. The corporate governance framework should assure that the rights of stakeholders that are protected by law are respected.

B. Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

C. The corporate governance framework should permit performance-enhancing mechanisms for stakeholder participation.

D. Where stakeholders participate in the corporate governance process, they should have access to relevant information.

IV. DISCLOSURE AND TRANSPARENCY

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

A. Disclosure should include, but not be limited to, material information on:

1. The financial and operating results of the company.
2. Company objectives.
3. Major share ownership and voting rights.
4. Members of the board and key executives, and their remuneration.
5. Material foreseeable risk factors.
6. Material issues regarding employees and other stakeholders.
7. Governance structures and policies.

B. Information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit.

C. An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.

D. Channels for disseminating information should provide for fair, timely and cost-efficient access to relevant information by users.

V. THE RESPONSIBILITIES OF THE BOARD

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

A. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

B. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

C. The board should ensure compliance with applicable law and take into account the interests of stakeholders.

D. The board should fulfil certain key functions, including:

1. Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.
2. Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.
3. Reviewing key executive and board remuneration, and ensuring a formal and transparent board nomination process.
4. Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.
5. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law.
6. Monitoring the effectiveness of the governance practices under which it operates and making changes as needed.
7. Overseeing the process of disclosure and communications.

E. The board should be able to exercise objective judgement on corporate affairs independent, in particular, from management.

1. Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are financial reporting, nomination and executive and board remuneration.
2. Board members should devote sufficient time to their responsibilities.

F. In order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.

Part Two

ANNOTATIONS TO THE OECD PRINCIPLES OF CORPORATE GOVERNANCE

I. THE RIGHTS OF SHAREHOLDERS

The corporate governance framework should protect shareholders' rights.

Equity investors have certain property rights. For example, an equity share can be bought, sold, or transferred. An equity share also entitles the investor to participate in the profits of the corporation, with liability limited to the amount of the investment. In addition, ownership of an equity share provides a right to information about the corporation and a right to influence the corporation, primarily by participation in general shareholder meetings and by voting.

As a practical matter, however, the corporation cannot be managed by shareholder referendum. The shareholding body is made up of individuals and institutions whose interests, goals, investment horizons and capabilities vary. Moreover, the corporation's management must be able to take business decisions rapidly. In light of these realities and the complexity of managing the corporation's affairs in fast moving and ever changing markets, shareholders are not expected to assume responsibility for managing corporate activities. The responsibility for corporate strategy and operations is typically placed in the hands of the board and a management team that is selected, motivated and, when necessary, replaced by the board.

Shareholders' rights to influence the corporation centre on certain fundamental issues, such as the election of board members, or other means of influencing the composition of the board, amendments to the company's organic documents, approval of extraordinary transactions, and other basic issues as specified in company law and internal company statutes. This Section can be seen as a statement of the most basic rights of shareholders, which are recognised by law in virtually all OECD countries. Additional rights such as the approval or election of auditors, direct nomination of board members, the ability to pledge shares, the approval of distributions of profits, etc., can be found in various jurisdictions.

A. Basic shareholder rights include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect members of the board; and 6) share in the profits of the corporation.

B. Shareholders have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental corporate changes such as: 1) amendments to the statutes, or articles of incorporation or similar governing documents of the company; 2) the authorisation of additional shares; and 3) extraordinary transactions that in effect result in the sale of the company.

C. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general shareholder meetings:

1. Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.

2. Opportunity should be provided for shareholders to ask questions of the board and to place items on the agenda at general meetings, subject to reasonable limitations.

In order to enlarge the ability of investors to participate in general meetings, some companies have increased the ability of shareholders to place items on the agenda by simplifying the process of filing amendments and resolutions. The ability of shareholders to submit questions in advance and to obtain replies from management and board members has also been increased. Companies are justified in assuring that frivolous or disruptive attempts to place items on the agenda do not occur. It is reasonable, for example, to require that in order for shareholder-proposed resolutions to be placed on the agenda, they need to be supported by those holding a specified number of shares.

3. Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia.

The Principles recommend that voting by proxy be generally accepted. Moreover, the objective of broadening shareholder participation suggests that companies consider favourably the enlarged use of technology in voting, including telephone and electronic voting. The increased importance of foreign shareholders suggests that on balance companies ought to make every effort to enable shareholders to participate through means which make use of modern technology. Effective participation of shareholders in general meetings can be enhanced by developing secure electronic means of communication and allowing shareholders to communicate with each other without having to comply with the formalities of proxy solicitation. As a matter of transparency, meeting procedures should ensure that votes are properly counted and recorded, and that a timely announcement of the outcome be made.

D. Capital structures and arrangements that enable certain shareholders to obtain a degree of control disproportionate to their equity ownership should be disclosed.

Some capital structures allow a shareholder to exercise a degree of control over the corporation disproportionate to the shareholders' equity ownership in the company. Pyramid structures and cross shareholdings can be used to diminish the capability of non-controlling shareholders to influence corporate policy.

In addition to ownership relations, other devices can affect control over the corporation. Shareholder agreements are a common means for groups of shareholders, who individually may hold relatively small shares of total equity, to act in concert so as to constitute an effective majority, or at least the largest single block of shareholders. Shareholder agreements usually give those participating in the agreements preferential rights to purchase shares if other parties to the agreement wish to sell. These agreements can also contain provisions that require those accepting the agreement not to sell their shares for a specified time. Shareholder agreements can cover issues such as how the board or the Chairman will be selected. The agreements can also oblige those in the agreement to vote as a block.

Voting caps limit the number of votes that a shareholder may cast, regardless of the number of shares the shareholder may actually possess. Voting caps therefore redistribute control and may affect the incentives for shareholder participation in shareholder meetings.

Given the capacity of these mechanisms to redistribute the influence of shareholders on company policy, shareholders can reasonably expect that all such capital structures and arrangements be disclosed.

E. Markets for corporate control should be allowed to function in an efficient and transparent manner.

1. The rules and procedures governing the acquisition of corporate control in the capital markets, and extraordinary transactions such as mergers, and sales of substantial portions of corporate assets, should be clearly articulated and disclosed so that investors understand their rights and recourse. Transactions should occur at transparent prices and under fair conditions that protect the rights of all shareholders according to their class.

2. Anti-take-over devices should not be used to shield management from accountability.

In some countries, companies employ anti-take-over devices. However, both investors and stock exchanges have expressed concern over the possibility that widespread use of anti-take-over devices may be a serious impediment to the functioning of the market for corporate control. In some instances, take-over defences can simply be devices to shield the management from shareholder monitoring.

F. Shareholders, including institutional investors, should consider the costs and benefits of exercising their voting rights.

The Principles do not advocate any particular investment strategy for investors and do not seek to prescribe the optimal degree of investor activism. Nevertheless, many investors have concluded that positive financial returns can be obtained by undertaking a reasonable amount of analysis and by exercising their voting rights. Some institutional investors also disclose their own policies with respect to the companies in which they invest.

II. THE EQUITABLE TREATMENT OF SHAREHOLDERS

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

Investors' confidence that the capital they provide will be protected from misuse or misappropriation by corporate managers, board members or controlling shareholders is an important factor in the capital markets. Corporate boards, managers and controlling shareholders may have the opportunity to engage in activities that may advance their own interests at the expense of non-controlling shareholders. The Principles support equal treatment for foreign and domestic shareholders in corporate governance. They do not address government policies to regulate foreign direct investment.

One of the ways in which shareholders can enforce their rights is to be able to initiate legal and administrative proceedings against management and board members. Experience has shown that an important determinant of the degree to which shareholder rights are protected is whether effective methods exist to obtain redress for grievances at a reasonable cost and without excessive delay. The confidence of minority investors is enhanced when the legal system provides mechanisms for minority shareholders to bring lawsuits when they have reasonable grounds to believe that their rights have been violated.

There is some risk that a legal system, which enables any investor to challenge corporate activity in the courts, can become prone to excessive litigation. Thus, many legal systems have introduced provisions to protect management and board members against litigation abuse in the form of tests for the sufficiency of shareholder complaints, so-called safe harbours for management and board member actions (such as the business judgement rule) as well as safe harbours for the disclosure of information. In the end, a balance must be struck between allowing investors to seek remedies for infringement of ownership rights and avoiding excessive litigation. Many countries have found that alternative adjudication procedures, such as administrative hearings or arbitration procedures organised by the securities regulators or other regulatory bodies, are an efficient method for dispute settlement, at least at the first instance level.

A. All shareholders of the same class should be treated equally.

1. Within any class, all shareholders should have the same voting rights. All investors should be able to obtain information about the voting rights attached to all classes of shares before they purchase. Any changes in voting rights should be subject to shareholder vote.

The optimal capital structure of the firm is best decided by the management and the board, subject to the approval of the shareholders. Some companies issue preferred (or preference) shares which have a preference in respect of receipt of the profits of the firm but which normally have no voting rights. Companies may also issue participation certificates or shares without voting rights, which would presumably trade at different prices than shares with voting rights. All of these structures may be effective in distributing risk and reward in ways that are thought to be in the best interest of the company and to cost-efficient financing. The Principles do not take a position on the concept of "one share one vote". However, many institutional investors and shareholder associations support this concept.

Investors can expect to be informed regarding their voting rights before they invest. Once they have invested, their rights should not be changed unless those holding voting shares have had the opportunity to participate in the decision. Proposals to change the voting rights of different classes of shares are normally submitted for approval at general shareholders meetings by a specified majority of voting shares in the affected categories.

2. Votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.

In some OECD countries it was customary for financial institutions which held shares in custody for investors to cast the votes of those shares. Custodians such as banks and brokerage firms holding securities as nominees for customers were sometimes required to vote in support of management unless specifically instructed by the shareholder to do otherwise.

The trend in OECD countries is to remove provisions that automatically enable custodian institutions to cast the votes of shareholders. Rules in some countries have recently been revised to require custodian institutions to provide shareholders with information concerning their options in the use of their voting rights. Shareholders may elect to delegate all voting rights to custodians. Alternatively, shareholders may choose to be informed of all upcoming shareholder votes and may decide to cast some votes while delegating some voting rights to the custodian. It is necessary to draw a reasonable balance between assuring that shareholder votes are not cast by custodians without regard for the wishes of shareholders and not imposing excessive burdens on custodians to secure shareholder approval before casting votes. It is sufficient to disclose to the shareholders that, if no instruction to the contrary is received, the custodian will vote the shares in the way he deems consistent with shareholder interest.

It should be noted that this item does not apply to the exercise of voting rights by trustees or other persons acting under a special legal mandate (such as, for example, bankruptcy receivers and estate executors).

3. Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.

In Section I of the Principles, the right to participate in general shareholder meetings was identified as a shareholder right. Management and controlling investors have at times sought to discourage non-controlling or foreign investors from trying to influence the direction of the company. Some companies charged fees for voting. Other impediments included prohibitions on proxy voting and the requirement of personal attendance at general shareholder meetings to vote. Still other procedures may make it practically impossible to exercise ownership rights. Proxy materials may be sent too close to the time of general shareholder meetings to allow investors adequate time for reflection and consultation. Many companies in OECD countries are seeking to develop better channels of communication and decision-making with shareholders. Efforts by companies to remove artificial barriers to participation in general meetings are encouraged.

B. Insider trading and abusive self-dealing should be prohibited.

Abusive self-dealing occurs when persons having close relationships to the company exploit those relationships to the detriment of the company and investors. Since insider trading entails manipulation of the capital markets, it is prohibited by securities regulations, company law and/or criminal law in most OECD countries. However, not all jurisdictions prohibit such practices, and in some cases enforcement is not vigorous. These practices can be seen as constituting a breach of good corporate governance inasmuch as they violate the principle of equitable treatment of shareholders.

The Principles reaffirm that it is reasonable for investors to expect that the abuse of insider power be prohibited. In cases where such abuses are not specifically forbidden by legislation or where enforcement is not effective, it will be important for governments to take measures to remove any such gaps.

C. Members of the board and managers should be required to disclose any material interests in transactions or matters affecting the corporation.

This item refers to situations where members of the board and managers have a business, family or other special relationship to the company that could affect their judgement with respect to a transaction.

III. THE ROLE OF STAKEHOLDERS IN CORPORATE GOVERNANCE

The corporate governance framework should recognise the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

A key aspect of corporate governance is concerned with ensuring the flow of external capital to firms. Corporate governance is also concerned with finding ways to encourage the various stakeholders in the firm to undertake socially efficient levels of investment in firm-specific human and physical capital. The competitiveness and ultimate success of a corporation is the result of teamwork that embodies contributions from a range of different resource providers including investors, employees, creditors, and suppliers. Corporations should recognise that the contributions of stakeholders constitute a valuable resource for building competitive and profitable companies. It is, therefore, in the long-term interest of corporations to foster wealth-creating co-operation among stakeholders. The governance framework should recognise that the interests of the corporation are served by recognising the interests of stakeholders and their contribution to the long-term success of the corporation.

A. The corporate governance framework should assure that the rights of stakeholders that are protected by law are respected.

In all OECD countries stakeholder rights are established by law, such as labour law, business law, contract law, and insolvency law. Even in areas where stakeholder interests are not legislated, many firms make additional commitments to stakeholders, and concern over corporate reputation and corporate performance often require the recognition of broader interests.

B. Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights.

The legal framework and process should be transparent and not impede the ability of stakeholders to communicate and to obtain redress for the violation of rights.

C. The corporate governance framework should permit performance-enhancing mechanisms for stakeholder participation.

Corporate governance frameworks will provide for different roles for stakeholders. The degree to which stakeholders participate in corporate governance depends on national laws and practices, and may vary from company to company as well. Examples of mechanisms for stakeholder participation include: employee representation on boards; employee stock ownership plans or other profit sharing mechanisms or governance processes that consider stakeholder viewpoints in certain key decisions. They may, in addition, include creditor involvement in governance in the context of insolvency proceedings.

D. Where stakeholders participate in the corporate governance process, they should have access to relevant information.

Where laws and practice of corporate governance systems provide for participation by stakeholders, it is important that stakeholders have access to information necessary to fulfil their responsibilities.

IV. DISCLOSURE AND TRANSPARENCY

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

In most OECD countries a large amount of information, both mandatory and voluntary, is compiled on publicly traded and large unlisted enterprises, and subsequently disseminated to a broad range of users. Public disclosure is typically required, at a minimum, on an annual basis though some countries require periodic disclosure on a semi-annual or quarterly basis, or even more frequently in the case of material developments affecting the company. Companies often make voluntary disclosure that goes beyond minimum disclosure requirements in response to market demand.

A strong disclosure regime is a pivotal feature of market-based monitoring of companies and is central to shareholders' ability to exercise their voting rights. Experience in countries with large and active equity markets shows that disclosure can also be a powerful tool for influencing the behaviour of companies and for protecting investors. A strong disclosure regime can help to attract capital and maintain confidence in the capital markets. Shareholders and potential investors require access to regular, reliable and comparable information in sufficient detail for them to assess the stewardship of management, and make informed decisions about the valuation, ownership and voting of shares. Insufficient or unclear information may hamper the ability of the markets to function, may increase the cost of capital and result in a poor allocation of resources.

Disclosure also helps improve public understanding of the structure and activities of enterprises, corporate policies and performance with respect to environmental and ethical standards, and companies' relationships with the communities in which they operate. The OECD Guidelines for Multinational Enterprises are relevant in this context.

Disclosure requirements are not expected to place unreasonable administrative or cost burdens on enterprises. Nor are companies expected to disclose information that may endanger their competitive position unless disclosure is necessary to fully inform the investment decision and to avoid misleading the investor. In order to determine what information should be disclosed at a minimum, many countries apply the concept of materiality. Material information can be defined as information whose omission or misstatement could influence the economic decisions taken by users of information.

The Principles support timely disclosure of all material developments that arise between regular reports. They also support simultaneous reporting of information to all shareholders in order to ensure their equitable treatment.

A. Disclosure should include, but not be limited to, material information on:

1. The financial and operating results of the company.

Audited financial statements showing the financial performance and the financial situation of the company (most typically including the balance sheet, the profit and loss statement, the cash flow statement and notes to the financial statements) are the most widely used source of information on companies. In their current form, the two principal goals of financial statements are to enable appropriate monitoring to take place and to provide the basis to value securities. Management's discussion and analysis of operations is typically included in annual reports. This discussion is most useful when read in conjunction with the accompanying financial statements. Investors are particularly interested in information that may shed light on the future performance of the enterprise.

It is important that transactions relating to an entire group be disclosed. Arguably, failures of governance can often be linked to the failure to disclose the "whole picture", particularly where off-balance sheet items are used to provide guarantees or similar commitments between related companies.

2. Company objectives.

In addition to their commercial objectives, companies are encouraged to disclose policies relating to business ethics, the environment and other public policy commitments. Such information may be important for investors and other users of information to better evaluate the relationship between companies and the communities in which they operate and the steps that companies have taken to implement their objectives.

3. Major share ownership and voting rights.

One of the basic rights of investors is to be informed about the ownership structure of the enterprise and their rights *vis-à-vis* the rights of other owners. Countries often require disclosure of ownership data once certain thresholds of ownership are passed. Such disclosure might include data on major shareholders and others that control or may control the company, including information on special voting rights, shareholder agreements, the ownership of controlling or large blocks of shares, significant cross shareholding relationships and cross guarantees. (See Section I.D.) Companies are also expected to provide information on related party transactions.

4. Members of the board and key executives, and their remuneration.

Investors require information on individual board members and key executives in order to evaluate their experience and qualifications and assess any potential conflicts of interest that might affect their judgement.

Board and executive remuneration are also of concern to shareholders. Companies are generally expected to disclose sufficient information on the remuneration of board members and key executives (either individually or in the aggregate) for investors to properly assess the costs and benefits of remuneration plans and the contribution of incentive schemes, such as stock option schemes, to performance.

5. Material foreseeable risk factors.

Users of financial information and market participants need information on reasonably foreseeable material risks that may include: risks that are specific to the industry or geographical areas; dependence on commodities; financial market risk including interest rate or currency risk; risk related to derivatives and off-balance sheet transactions; and risks related to environmental liabilities.

The Principles do not envision the disclosure of information in greater detail than is necessary to fully inform investors of the material and foreseeable risks of the enterprise. Disclosure of risk is most effective when it is tailored to the particular industry in question. Disclosure of whether or not companies have put systems for monitoring risk in place is also useful.

6. Material issues regarding employees and other stakeholders.

Companies are encouraged to provide information on key issues relevant to employees and other stakeholders that may materially affect the performance of the company. Disclosure may include management/ employee relations, and relations with other stakeholders such as creditors, suppliers, and local communities.

Some countries require extensive disclosure of information on human resources. Human resource policies, such as programmes for human resource development or employee share ownership plans, can communicate important information on the competitive strengths of companies to market participants.

7. Governance structures and policies.

Companies are encouraged to report on how they apply relevant corporate governance principles in practice. Disclosure of the governance structures and policies of the company, in particular the division of authority between shareholders, management and board members is important for the assessment of a company's governance

B. Information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit.

The application of high quality standards is expected to significantly improve the ability of investors to monitor the company by providing increased reliability and comparability of reporting, and improved insight into company performance. The quality of information depends on the standards under which it is compiled and disclosed. The Principles support the development of high quality internationally recognised standards, which can serve to improve the comparability of information between countries.

C. An annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented.

Many countries have considered measures to improve the independence of auditors and their accountability to shareholders. It is widely felt that the application of high quality audit standards and codes of ethics is one of the best methods for increasing independence and strengthening the standing of the profession. Further measures include strengthening of board audit committees and increasing the board's responsibility in the auditor selection process.

Other proposals have been considered by OECD countries. Some countries apply limitations on the percentage of non-audit income that the auditor can receive from a particular client. Other countries require companies to disclose the level of fees paid to auditors for non-audit services. In addition there may be limitations on the total percentage of auditor income that can come from one client. Examples of other proposals include quality reviews of auditors by another auditor, prohibitions on the provision of non-audit services, mandatory rotation of auditors and the direct appointment of auditors by shareholders.

D. Channels for disseminating information should provide for fair, timely and cost-efficient access to relevant information by users.

Channels for the dissemination of information can be as important as the content of the information itself. While the disclosure of information is often provided for by legislation, filing and access to information can be cumbersome and costly. Filing of statutory reports has been greatly enhanced in some countries by electronic filing and data retrieval systems. The Internet and other information technologies also provide the opportunity for improving information dissemination.

V. THE RESPONSIBILITIES OF THE BOARD

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

Board structures and procedures vary both within and among OECD countries. Some countries have two-tier boards that separate the supervisory function and the management function into different bodies. Such systems typically have a "supervisory board" composed of non-executive board members and a "management board" composed entirely of executives. Other countries have "unitary" boards, which bring together executive and non-executive board members. The Principles are intended to be sufficiently general to apply to whatever board structure is charged with the functions of governing the enterprise and monitoring management.

Together with guiding corporate strategy, the board is chiefly responsible for monitoring managerial performance and achieving an adequate return for shareholders, while preventing conflicts of interest and balancing competing demands on the corporation. In order for boards to effectively fulfil their responsibilities they must have some degree of independence from management. Another important board responsibility is to implement systems designed to ensure that the corporation obeys applicable laws, including tax, competition, labour, environmental, equal opportunity, health and safety laws. In addition, boards are expected to take due regard of, and deal fairly with, other stakeholder interests including those of employees, creditors, customers, suppliers and local communities. Observance of environmental and social standards is relevant in this context.

A. Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.

In some countries, the board is legally required to act in the interest of the company, taking into account the interests of shareholders, employees, and the public good. Acting in the best interest of the company should not permit management to become entrenched.

B. Where board decisions may affect different shareholder groups differently, the board should treat all shareholders fairly.

C. The board should ensure compliance with applicable law and take into account the interests of stakeholders.

D. The board should fulfil certain key functions, including:

1. **Reviewing and guiding corporate strategy, major plans of action, risk policy, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.**
2. **Selecting, compensating, monitoring and, when necessary, replacing key executives and overseeing succession planning.**
3. **Reviewing key executive and board remuneration, and ensuring a formal and transparent board nomination process.**
4. **Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.**
5. **Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for monitoring risk, financial control, and compliance with the law.**
6. **Monitoring the effectiveness of the governance practices under which it operates and making changes as needed.**
7. **Overseeing the process of disclosure and communications.**

The specific functions of board members may differ according to the articles of company law in each jurisdiction and according to the statutes of each company. The above-noted elements are, however, considered essential for purposes of corporate governance.

E. The board should be able to exercise objective judgement on corporate affairs independent, in particular, from management.

The variety of board structures and practices in different countries will require different approaches to the issue of independent board members. Board independence usually requires that a sufficient number of board members not be employed by the company and not be closely related to the company or its management through significant economic, family or other ties. This does not prevent shareholders from being board members.

Independent board members can contribute significantly to the decision-making of the board. They can bring an objective view to the evaluation of the performance of the board and management. In addition, they can play an important role in areas where the interests of management, the company and shareholders may diverge such as executive remuneration, succession planning, changes of corporate control, take-over defences, large acquisitions and the audit function.

The Chairman as the head of the board can play a central role in ensuring the effective governance of the enterprise and is responsible for the board's effective function. The Chairman may in some countries, be supported by the company secretary. In unitary board systems, the separation of the roles of the Chief Executive and Chairman is often proposed as a method of ensuring an appropriate balance of power, increasing accountability and increasing the capacity of the board for independent decision making.

1. **Boards should consider assigning a sufficient number of non-executive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are financial reporting, nomination and executive and board remuneration.**

   While the responsibility for financial reporting, remuneration and nomination are those of the board as a whole, independent non-executive board members can provide additional assurance to market participants that their interests are defended. Boards may also consider establishing specific committees to consider questions where there is a potential for conflict of interest. These committees may require a minimum number or be composed entirely of non-executive members.

2. **Board members should devote sufficient time to their responsibilities.**

   It is widely held that service on too many boards can interfere with the performance of board members. Companies may wish to consider whether excessive board service interferes with board performance. Some countries have limited the number of board positions that can be held. Specific limitations may be less important than ensuring that members of the board enjoy legitimacy and confidence in the eyes of shareholders.

   In order to improve board practices and the performance of its members, some companies have found it useful to engage in training and voluntary self-evaluation that meets the needs of the individual company. This might include that board members acquire appropriate skills upon appointment, and thereafter remain abreast of relevant new laws, regulations, and changing commercial risks.

F. In order to fulfil their responsibilities, board members should have access to accurate, relevant and timely information.

Board members require relevant information on a timely basis in order to support their decision-making. Non-executive board members do not typically have the same access to information as key managers within the company. The contributions of non-executive board members to the company can be enhanced by providing access to certain key managers within the company such as, for example, the company secretary and the internal auditor, and recourse to independent external advice at the expense of the company. In order to fulfil their responsibilities, board members should ensure that they obtain accurate, relevant and timely information.

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