Securing the future of pensions

Organisation for Economic Co-operation and Development
Corporate Governance Committee
2, rue André Pascal
75775 Paris Cedex 16
France

December 2014

Dear Sir/Madam,

**NAPF response to draft revised OECD principles on corporate governance**

The NAPF is the voice of workplace pensions in the UK. We speak for over 1,300 pension schemes that provide pensions for over 17 million people and have more than £900 billion of assets. We also have 400 members from businesses supporting the pensions sector.

We aim to help everyone get more out of their retirement savings. To do this we spread best practice among our members, challenge regulation where it adds more cost than benefit and promote policies that add value for savers.

We welcome the opportunity to comment upon the OECD Corporate Governance Committee's draft revision of the OECD Principles of Corporate Governance. It is the belief of our members that efforts to encourage an engaged shareholder base alongside robust standards of governance, transparency and protection of minority shareholder rights should enhance the attractiveness of investment in capital markets and in turn be beneficial for both investors and issuers, and so play a role in driving economic growth.

The OECD Principles on Corporate Governance have for some time proved to be an important reference point and standard for national policymakers and regulators as well as, in emerging markets in particular, corporations and investors in their efforts to design and improve their corporate governance frameworks and practices. It has however, been some time since the Principles were last updated and therefore it is right that they are now revisited in order to reflect and ensure they are still in keeping with current expectations of best practice – after all much has changed in recent years.

The NAPF believes that for the OECD Principles to maintain their relevance, status and usefulness it is important that the OECD is ambitious in its revisions and endeavours to more than simply keep pace with the latest developments. If the resultant revised Principles are not suitably ambitious they risk being out of date soon after publication. With institutional investors increasingly investing across global markets the OECD Corporate Governance Principles can play an critical role in enhancing investor confidence in the governance standards and frameworks within emerging markets and fostering wider, deeper and better functioning capital markets.

Broadly speaking we support and appreciate the direction of travel inherent within the proposed revisions to the Principles. The proposed revisions as is appropriate cover a broad array of issues and do reflect many of the important corporate governance developments which have occurred during the past decade. That said, there are a number of areas where we would urge the Committee to go further and be more ambitious. We have summarised these below.

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**Stewardship**

The Principles at present fail appropriately or explicitly to address one of those areas to which there has been very significant attention paid over recent years - the need for engaged stewardship of investee companies by institutional investors. This is an area that many nation states are increasingly recognising as crucial to promoting the long term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship by investors involves the considered exercising of shareholder rights alongside intelligent and active monitoring and engagement with companies on a broad range of issues.

The Committee will no doubt be aware of the UK Stewardship Code, commonly accepted as the first of its kind in the world, and equally the Committee will I'm sure have noted that many other countries have since introduced their own very similar versions with Japan being one of the most recent. Indeed, the European Commission is presently advocating for all institutional investors and asset managers to be required to disclose (on a comply-or-explain basis) their engagement policy.

A culture of effective and constructive shareholder engagement is necessary to ensure that corporate disclosures are not communicated into a vacuum but instead that companies are properly accountable to their owners; such a relationship should help them to look beyond the short-term and instead to focus on achieving sustainable success in the interests of both parties. In order to foster this beneficial relationship between issuers and their investors requires attention to be given to encouraging shareholders to reflect and account for their abilities and willingness to commit time and resources to engagement activities as much as it depends on the attitude and responsiveness of the boards themselves.

In the context of the debate on stewardship, we welcome the increased discussion of the investment chain and the challenges that come with its degree of intermediation. In particular, we support the addition of a call for fund manager and other intermediary fees to be made transparent. This would be a powerful and helpful move in the right direction.

**Sustainability**

The NAPF is a strong supporter of efforts to improve the level and quality of corporate reporting on non-financial information and we note and welcome sustainability and integrated reporting being mentioned within the proposed Principles. We do however; feel that this area could warrant expanding further.

In particular, we suggest that the Principles could more clearly discuss the importance of Boards' taking ownership of the company's sustainability and viability. We would expect a Board actively to discuss, consider and report on those risk factors which might materially impact on company performance over the short, medium and longer-term – such risks would almost certainly include key environmental and social risks to their business model.

At present there is a year on year increase in the level of attention many institutional investors are giving to this agenda as the understanding of how certain risks may impact on certain businesses and certain sectors grows. Whilst the quality of corporate reporting in this area has similarly responded thus resulting in richer discussions there remains significant scope for further improvement and a raising of standards globally. With the importance of this issue having been recognised by national and international bodies including in 2012 for the first time at the United Nations Conference on Sustainable Development in Rio there is significant merit in the OECD striving to take more of a lead in this area.

**The role of stock exchanges**

The NAPF welcomes the acknowledgement within the revised Principles to the important role of stock exchanges and trading venues in terms of standard setting, supervision and enforcement of corporate governance standards.

Of course in reality, stock exchanges as regulated private enterprises are highly commercial organisations with an obvious interest in the level of trading on their exchanges which is at odds with a traditional buy-and-hold investing model. Consequently, we believe it is important to find ways to balance these interests and ensure that the public good element of their function is not lost. The Sustainable Stock Exchanges initiative is one such positive initiative aimed at exploring how exchanges can work together with investors, regulators, and companies to enhance corporate transparency, and ultimately performance, on environmental, social and corporate governance issues and encourage responsible long-term approaches to investment. This initiative has had a fair degree of success and greater emphasis on the issues raised by these debates within the OECD's Corporate Governance Principles would undoubtedly be helpful in maintaining momentum.

**Particular corporate governance issues**

*The role of statutory auditor*

Given the absolutely crucial role played by the external statutory auditor to maintaining trust in the integrity of financial reporting it is a surprise to note the lack of any reference to their role within these Principles. High quality audits undertaken by trusted and independent auditors are vital for investor and ultimately market confidence. Without this confidence the cost of capital would be much higher and liquidity would significantly reduce.

The importance of the audit and of restoring trust in its function has been the focus of much attention within Europe and in particular within the UK over the past few years. The ultimate clients of the audit are investors, however, until the past year the insight they received into the work that underpinned the resultant audit opinion was very limited, this is beginning to change with new enhanced auditor reports in the UK and this sea change has been very well received and is of potentially great benefit to investors.

Whilst quality of the audit is the primary intent of investors, a crucial ingredient of this is the independence of the auditor. External auditors are paid by the issuers whom they are auditing which of course poses obvious challenges to their professional scepticism. This independence is further challenged when the same auditor is in receipt of significant fees for the provision of non-audit services including for those matters such as tax advisory services to which they also audit. Furthermore, the length of many auditor tenures commonly stretch out many decades posing further challenges to the real or perceived independence of the auditor. It is vitally important therefore that the auditor appointment process is owned by the audit committee and not management and that it is to both the audit committee and ultimately investors that the auditors clearly report.

*CEO/Chairman combination*

The revisions encourage companies where a single person combines the roles of CEO and Chair to clarify the rationale behind this arrangement. While the NAPF acknowledges that this proposed amendment is a move in the right direction, we do believe that the OECD Principles would be better served it took this a step further.

It is a long-established principle of good governance that no single individual should have unfettered powers of decision and that as such the roles of CEO and Chair should be separate. The contravention of this tenet would be of significant concern to many investors as without the clearly separated functions it would become very difficult to establish a good governance structure and proper checks and balances within the board. We therefore urge the OECD to consider following many others in making a separation of the roles of CEO and Chairman an explicit expectation within the OECD Principles even if it is one where exceptions can be explained.

*'One share one vote'*

Whilst the OCED current Principles take a neutral position many institutional investors and shareholder associations strongly support the concept of 'one share one vote'. The proposed revisions appear to advocate removing this note entirely, we strongly encourage the OECD to reconsider this aspect.

'One share one vote' is based on the principle that the voting and dividend equity interest in a listed company should be proportional to the capital contribution of the shares. A number of countries – e.g. France and Italy - have recently introduced mechanisms to grant multiple voting rights to certain long term shareholders, thereby setting aside the interests of minority shareholders. It is our belief that these mechanisms in actuality result in the disenfranchisement of many overseas long-term shareholders. Therefore, we believe it is fundamentally important to maintain the reference to the 'one share one vote' concept in the Principles.

*The plumbing*

One area where there continues to be significant consternation amongst investors is the continued failure properly to address the voting chain; in particular the poor performance of the intermediaries in the chain which make it very difficult and often very costly for small and large shareholders to exercise their voting rights, especially cross–border, and for issuers in many markets to know who their real owners are. Shareholder identification should be easily accessible both by issuers and by shareholders.

Equally, whilst the increasingly ability for investors to exercise their voting rights by electronic means has been widely adopted and has enabled investors with international equity portfolios to increasingly vote their shares on a cross-border basis several obstacles do remain. Voting remains a bafflingly costly, time-consuming and inefficient process. Earlier in 2014 the International Corporate Governance Network (ICGN) highlighted many of the most important obstacles and made some recommendations for improvement.[1] The NAPF believes that the OECD Principles would be enhanced by further articulation of the key elements of these recommendations as without improvements in this area real progress will be perennially blighted by antiquated infrastructure.

As before, we very much welcome the consultation exercise and the efforts to update the principles. I hope our comments are useful and as always would be very happy to discuss further with you any of the points we have raised in this response.

Yours sincerely

Will Pomroy
Policy Lead: Corporate Governance and Stewardship, NAPF

[1] https://www.icgn.org/images/ICGN_Viewpoint_Shareholder_Rights_Vote_execution_website.pdf.