ICGN
International Corporate Governance Network

IOSCO GEM COMMITTEE

CORPORATE GOVERNANCE TASK FORCE

QUESTIONNAIRE

I. Background

As revealed in the discussions held in the last IOSCO Growth and Emerging Markets Committee ("GEM Committee") meetings, the reform of corporate governance structures in GEM economies is critical for the sustainable growth of market based activities.

In this context, the GEM Committee agreed that corporate governance should be one of the three technical and policy priorities for the Committee to undertake in the near future.

Following such discussions, the GEM Committee also agreed that the CVM Brazil would take the lead of a **Corporate Governance Task Force** ("CGTF"), which membership has been open to IOSCO GEM members. The respective project specifications for the mandate were circulated to GEM members on July 2015, and approved by written procedure on August 19, 2015.

The CGTF is composed of 16 GEM members[1], and, based on the project specifications, it was agreed to narrow the scope of the work, focusing on specific key topics, as follows:

(i) Board composition, attributions, accountability and responsibility
(ii) Incentive structures and remuneration schemes
(iii) Risk management

[1] CVM Brazil, SC Malaysia, FSB South Africa, CMB Turkey, SEC Thailand, FSC Jamaica, Egypt FSA, CNBV Mexico, SEC Pakistan, Bangladesh SEC, SC Bahamas, The Bank of Russia, CNV Argentina, CMC Angola, Indonesia FSA and SEC Sri Lanka.

The CGTF members also agreed that the work shall consider existing principles (as the OECD Global Corporate Governance Principles[2]), in order to develop our views on how they should be best deployed, from a regulatory perspective, in our capital markets.

The CGTF is also expected to identify common concerns and challenges among jurisdictions, as well as good and bad experiences in the implementation of corporate governance practices, recognizing the main gaps between theory and market reality.

Questions concerning state-owned enterprises (SOEs) and small and medium enterprises (SMEs) are also sensitive issues that should be contemplated, where applicable, in the findings and views concerning the development and implementation of corporate governance practices.

In this sense, the CGTF is intended to make not only a diagnoses, but effective recommendations on how capital markets regulators may guide the adoption of best corporate governance practices and in terms of changing of "culture" related to this subject.

II. Objective

The following questionnaire is intended to gather information on the status of the subject in GEM jurisdictions, including recent and concrete examples of positive advances and poor experiences, and collect the views of regulators and key market agents concerning sensitive topics of corporate governance.

The findings of this questionnaire will provide essential subsidies for the development and representativeness of the report to be prepared by the CGTF.

III. Respondent data

Name: George Dallas
Organisation: International Corporate Governance Network[3]
Jurisdiction: UK based (but our policy framework and our responses reflect <u>global</u> standards, not an individual jurisdiction)

[2] Recently reviewed by OECD, and submitted to the approval by G20 members.
[3] The International Corporate Governance Network (ICGN) is an investor-led membership organisation of more than 670 individuals based in 47 countries. Our mission is to inspire and promote effective standards of corporate governance to support the sustainable value creation of companies and to advance efficient markets and economies world-wide. Our membership includes institutional investors with global assets under management in excess of US$26 trillion, as well as other stakeholders including company directors, professional advisors and academics.

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IV. Questions

OVERVIEW

Concrete examples

1) Please provide, if available, two (2) recent examples of relevant measures or initiatives concerning the implementation of best practices of corporate governance in your jurisdiction (or business segment, as the case may be).

We would cite our Global Governance Principles (last updated in 2014) and the ICGN draft Global Stewardship Principles that will be put forward for member approval in June 2016, following a consultation period. ICGN will also be publishing in March 2016, in cooperation with the Institute of Business Ethics in the UK, a paper focusing on culture, ethics and risk in companies. [4]

2) Please provide, if available, two (2) recent examples of material poor experiences, in your jurisdiction (or business segment, as the case may be) that could have been avoided or mitigated through better corporate governance practices.

It is not ICGN's policy to assess governance standards of individual companies. Our focus is more on establishing principle-based policies to guide our members (mainly institutional investors, companies, academics and service providers). Having said that, we identify as a concern the use of differential ownership rights in many jurisdictions (notably France with its Florange Act) to marginalize the rights of minority shareholders and diminish the accountability of controlling shareholders. We are also concerned about the influences of a weak corporate culture and poor risk management. While there may be many examples to choose from, we can cite the recent emissions scandal at Volkswagen, the corruption scandal at Petrobras in Brazil and the past (and in some cases) ongoing governance problems in the US and Western European banking sectors.

[4] For ICGN policy documents please see: https://www.icgn.org/policy In addition to its Global Governance Principles, ICGN has member-approved guidance on a range of topics, including board diversity, remuneration and risk management, where these issues are framed as matters of corporate governance from an investor perspective.

Methodologies

3) Please provide your views concerning the effectiveness of methodologies as "comply or explain" and "apply and/or explain", addressing, when applicable, the following issues.

A) How can we ensure that the "explain" comments match real situation? Which criteria should regulators develop/use in assessing the appropriateness of the explanations?

B) Which type of practices should always be refused as inappropriate explanations?

It is difficult to ensure that explanations are always appropriate or adequate. A mechanistic formula to assess explanations could lead to gaming or have other unintended consequences. Readers of explanations—which include investors as well as regulators—have to use judgment when assessing explanations to determine if explanations are credible. An explanation that comes across as thoughtful and customized to the company's own circumstances has the greatest chance for credibility. Explanations that come across as superficial lip service are not likely to be convincing. Investors will likely compare a company's weak response with its peers or with other companies in the sector that have more developed explanations. The role of the regulator, or body which will be reviewing the responses, must be clearly established. An audit mechanism in which an independent body selects a variety of company "comply or explain" statements should be part of the regulatory framework. The ICGN has written a number of consultation letters to provide suggested ways to develop these standards without being overly formulaic.

ICGN recognizes that this questionnaire focuses in part on governance practices in emerging markets, which in some cases may not have the investor infrastructure to rigorously monitor the quality of company explanations. In such jurisdictions, principles-based codes on a comply or explain framework may lack traction in some cases due to the lack of enforcement. This concern is reflected in the many questionnaire questions focusing on whether some traditionally voluntary governance principles should be made mandatory to ensure they are put into place. ICGN would encourage caution about requiring prescriptive governance practices without clear evidential justification, as these can result in unintended consequences.

State-owned enterprises (SOEs)

4) Whereas listed state-owned enterprises (SOEs) account for a significant part of market capitalization in some of the GEM jurisdictions, potential failures within this segment may have a large negative impact in such economies.

In this sense, and bearing in mind the particularities of such companies, please provide your views on the following issues:

A) In your view, should listed SOEs be submitted to differentiated corporate governance requirements or levels of compliance?

SOEs carry intrinsic conflicts of interest given potential misalignment between state and investor interests. As with other forms of controlled companies, these conflicts should be understood and mitigated. It is important in these cases for a company's board to have a sufficient amount of independent representation to protect the interests of minority investors. Related party transactions in particular should be subject to independent director approval, and, if material in scale, should be presented to non-controlling shareholders for approval.

B) What should be the limits of government influence in listed SOEs' business decisions? How to ensure a depoliticized and meritocratic board composition and management of staff? Please elaborate on how it is done in your jurisdiction, if applicable.

Government influence in a listed SOE should not be used to advance the government's agenda at the expense of the company's sustainable long-term value creation. All directors, including those nominated or approved by the government, should be given clear training on their fiduciary duty of care to the firm as a whole—and not simply to represent the interests of others, such as controlling shareholders. A shareholder agreement may be a good way to articulate the controlling owner's relationship with the company in terms of governance and broader strategic or financial influence.

Small and medium enterprises (SMEs)

5) In your view, should regulators establish different levels of compliance concerning small and medium enterprises (SMEs)? If so, how flexible and lenient should regulators be regarding this segment? Please provide concrete examples of measures or initiatives in your jurisdiction, if applicable.

SMEs, particularly those that have public listings, should adhere to the same broad principles of governance as large cap companies. These principles include fairness, transparency, accountability and responsibility. However since SMEs are by definition smaller, their specific governance practices should be proportionate and need not be as elaborate as with larger companies. We do not advocate differing standards of governance for SMEs, but we do believe that SMEs can use explanations to articulate any differences from governance code practices on the basis of the company's size and the stage of its life cycle. Independent audit standards should be complied with regardless of company size.

WS1 – BOARD COMPOSITION

Diversity

6) How critical do you view board diversity (i.e., age, expertise, experience, gender, ethnicity)? In your opinion, should regulators play an active role in encouraging diversity among board members? If so, what should be the points of attention, and how they might be addressed (i.e. mandatory requisites, 'comply or explain' methodology)?

ICGN attaches great importance to board diversity across a wide range of factors. These include the factors cited above as well as special skills required by the board. Regulators could call for disclosure on a company's measurable diversity targets (both executive and non-executive) and for companies to report their progress against such targets. Guidance on diversity will be presented to the ICGN membership in June 2016 for vote at the annual meeting. Gender Diversity on Company Boards Guidance was ratified by the membership in 2013 and is available on the ICGN website.

Independence

7) Some jurisdictions have introduced regulations to support board independence, providing, for instance, a definition of an independent director and/or prescribing a minimum number of independent board members.

Given the importance of board independence for a successful corporate governance structure, how do you consider regulators should effectively address this key issue? Please also elaborate relevant measures or initiatives in place in your jurisdiction, if applicable.

Definitions of independence should be robust and reflect a director's ability to exercise judgment free of external influence. ICGN's Global Governance Principles state that the board should explain its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:

- is or has been employed in an executive capacity by the company or a subsidiary and there has not been an appropriate period between ceasing such employment and serving on the board;
- is or has within an appropriate period been a partner, director or senior employee of a provider of material professional or contractual services to the company or any of its subsidiaries;
- receives or has received additional remuneration from the company apart from a director's fee, participates in the company's share option plan or a performance-related pay scheme, or is a member of the company's pension scheme;
- has or had close family ties with any of the company's advisers, directors or senior management;
- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- is a significant shareholder of the company, or an officer of, or otherwise associated with, a significant shareholder of the company;
- is or has been a nominee director as a representative of minority shareholders or the state;
- has been a director of the company for such a period that his or her independence may have become compromised.

Even for companies with controlling shareholders ICGN believes that there should be a critical mass of independent directors on the board; a minimum of three independent directors may be suitable for companies with boards in excess of 10 directors.

Time availability

8) In your view, should regulators consider limits on the number of boards a director serves? Please elaborate on how it is done in your jurisdiction, if applicable. If available, please provide concrete examples of relevant measures in place to ensure that a director can properly focus on and devote to each board he/she serves.

The board of directors should meet regularly to discharge its duties and directors should allocate adequate time to meeting preparation and attendance. Board members should know the business, its operations and senior management well enough to contribute effectively to board discussions and decisions.

ICGN has no policy that strictly defines the number of boards that a director may serve. However, the number, and nature, of board appointments an individual director holds (particularly the chair of the board and of key committees, and executive directors) should be carefully considered and reviewed on a regular basis and the degree to which each individual director has the capacity to undertake multiple directorships should be clearly disclosed. Many investors have policies against director “overboarding” and will withhold a vote from a director that has too many commitments.

Limits on terms

9) In your view, long stretches of service may prejudice a director’s ability to act independently? If so, should regulators consider limits on the number of terms a director may serve on a specific company? Please elaborate on how it is done in your jurisdiction, if applicable.

ICGN would agree that long stretches of service may impact a director’s independence, but this does not mean that directors should necessarily serve term limits; indeed in some jurisdictions directors stand for election or re-election on an annual basis. One aspect of board diversity, for example, can include both long board service and new blood to the board. Both can make valuable contributions to the board. However, longstanding directors should not be classified as independent and serve on committees (such as audit) where independence is a key criterion. It can be arbitrary putting forward a time period at which a long serving director is deemed as independent. But to cite the UK case, 9 years of service is often used as a proxy for defining where a director should no longer be considered independent. Investors would like boards to disclose their policies on board tenure and refreshment, as well as their pursuit of more diverse board members when there are openings on the board. A term limit could act as support for the Chairman and Nominations committee to refresh the board and help build diversity. A requirement for a succession plan could reinforce independence and the increasing importance of diversity.

Nomination subcommittee

10) In your view, should the setting up of a nomination subcommittee be mandatory? Please elaborate on how it is done in your jurisdiction, if applicable.

Normally a company should have a nomination committee comprised of non-executive directors, the majority of whom are independent. This need not be a legal requirement, for example SMEs may have different requirements. But in such cases a company should explain why it does not have a majority independent nomination committee.

Minority shareholders influence

11) In countries where controlling shareholders and concentrated ownership structures are common, minority shareholders often feel powerless to influence the outcome of board elections.

Bearing this in mind, should regulators mandate the use of cumulative voting in the election of directors to facilitate more active participation by all shareholders in the board nomination and election process? Please elaborate on how it is done in your jurisdiction, if applicable.

ICGN does not have a policy position on cumulative voting, though its relevance is arguably greater in controlled companies than in companies that are widely held. For controlled companies this can offer a way for minority shareholders to have more influence on board composition, particularly with regard to independent representation.

Board evaluation

12) In your view, how should regulators foster the implementation and effectiveness of periodic evaluations of the board (encompassing the assessment of individual members and subcommittee's efficiency and performance)? Should the board retain an external facilitator to perform this task? Please elaborate on how it is done in your jurisdiction, if applicable.

ICGN's Global Governance Principles state that the nomination committee should evaluate the process for a rigorous review of the performance of the individual directors, the company secretary (where such a position exists), the board's committees and the board as a whole prior to being proposed for re-election. The board of directors should also periodically (preferably every three years) engage an independent outside consultant to undertake the evaluation. The non-executive directors, led by the lead independent director, should be responsible for performance evaluation of the chair, taking into account the views of executive officers. The board should disclose the process for evaluation and, as far as reasonably possible, any material issues of relevance arising from the conclusions and any action taken as a consequence.

WS2 – INCENTIVE STRUCTURES AND REMUNERATION SCHEMES

13) Please provide your views about what should be the role of main corporate bodies (shareholders meeting, board of directors, executive board) in the definition of remuneration policies. Please describe how it is done in your jurisdiction, if applicable.

A remuneration committee should be established and comprised of non-executive directors, the majority of whom are independent. The main role and responsibilities of the remuneration committee should be described in the committee terms of reference. This includes:

- determining and recommending to the board the remuneration philosophy and policy of the company;
- designing, implementing, monitoring and evaluating short-term and long-term share-based incentives and other benefits schemes including pension arrangements, for all executive officers;
- ensuring that conflicts of interest among committee members and between the committee and its advisors are identified and avoided;
- appointing any independent remuneration consultant including their selection and terms of engagement and disclosing their identity and consulting fees; and

- maintaining appropriate communication with shareholders on the subject of remuneration either directly or via the board.

Shareholders should have an opportunity to vote on the remuneration policies, particularly where significant change to remuneration structures is proposed or where significant numbers of shareholders have opposed a remuneration resolution. In particular, share-based remuneration plans should be subject to shareholder approval before being implemented.

14) In your view, should the shareholders meeting approve in advance all long-term equity-based and other incentive schemes or any substantive changes to existing schemes? Please describe how it is done in your jurisdiction, if applicable.

Share-based remuneration plan and subsequent potential dilution of shareholders should require prior shareholder approval. Committees should also seek shareholder approval regarding key amendments to long-term incentive arrangements, including changes to performance targets.

15) Should regulators require companies to have a compensation subcommittee, in order to regularly review incentive schemes? If so, what should be its composition? Please elaborate on how it is done in your jurisdiction, if applicable.

Normally companies should have a remuneration committee responsible for all aspects of the remuneration arrangements from drafting to implementing remuneration arrangements. It is also responsible for integrating all components of remuneration into a cohesive structure. This structure must be aligned with, and support, the strategic objectives of the company over both the short-term and the long-term.

Ideally, the committee should be comprised of entirely independent non-executive directors or supervisory board members. At a minimum, a majority of its members should be independent. In particular, the chair of the committee should be independent.

To ensure that there is not too much power vested in any one individual and to ensure adequate time to fulfil both functions, the chair of the board, or a senior independent director if the chair role is not filled by an independent board member, should not also be the chair of the committee.

Special care should be taken to ensure that the committee as a whole has adequate qualifications, experience and expertise, together with diverse perspectives.

The committee should normally consist of at least three members.

Current serving CEOs of other companies may have a potential conflict or bias in setting their peers' remuneration. As such, committees should be aware that many investors prefer a strict limit on the number of CEOs on the committee (such as one), or an outright ban.

An independent remuneration committee need not be a legal requirement, for example SMEs may have different approaches given their scales and stage of development. But in such cases a company should explain why it does not have a majority independent nomination committee.

16) Should executive and board compensation policy (detailing basic remuneration, short-term bonuses, long-term rewards, stock options, termination and retirement provisions), as well as the amount of individual compensation, be disclosed in annual integrated reports? Please elaborate on how it is done in your jurisdiction, if applicable.

A clear, understandable and comprehensive remuneration policy should be disclosed, which is aligned with the company's long-term strategic objectives. The remuneration report should also describe how awards granted to individual directors and the CEO were determined and deemed appropriate in the context of the company's underlying performance in any given year. This extends to non-cash items such as director and officer insurance, fringe benefits and terms of severance packages if any. Caution needs to be taken if requiring the disclosure of each component of each director's remuneration arrangements. It may be argued that significant increases in directors' remuneration have resulted from benchmarking exercises, alone.

17) Should regulators require a sensible balance between variable remuneration/bonus compared to fixed remuneration (i.e., considering limits)? Please elaborate on how it is done in your jurisdiction, if applicable.

A sensible balance is desirable but a fixed ratio can be problematic, particularly as a sector can have differing remuneration dynamics. However companies should develop sensitivity to income imbalances and to growing public concerns in many jurisdictions about the high quantum of pay for executives in the context of growing economic inequality.

18) **Should regulators require companies to adopt remuneration policies linked to corporate/individual performance, with transparent and easily comparable measure of performance (“pay for performance”)? Please provide concrete examples of measures in your jurisdiction, if available.**

The regulatory focus should be on company transparency, encouraging independent remuneration committees and a shareholder vote on pay. A regulatory requirement prescribing pay structures is problematic and can result in unintended consequences. Some markets have arrived at a disclosure document -- for example, the Compensation, Disclosure and Analysis (CD&A) document in the US-- which can help investors compare the link between pay and performance between company peers.

WS3 – RISK MANAGEMENT

19) **In your view, what should be the disclosure requirements concerning internal controls and risk monitoring and management policies? Please elaborate on how it is done in your jurisdiction, if applicable.**

The board should concisely disclose information sufficient for investors to make judgments on the quality of the board’s oversight of the risk management process. Disclosure should be made at least annually, in conjunction with the company’s regular financial reporting process. Boards should provide investors with a statement that includes information on risk oversight procedures and board perspectives on risk in the approved strategy. This should be in a text identified as distinct from any reports or disclosures issued by management concerning specific risks faced by the company. The disclosure statement should be consistent with the size and complexity of the company. Boards should explain to investors those aspects of the corporate governance structure that the board relies upon to oversee the strategy and material risks of the company, including whether a board level committee specialised in risk exists, the nature of its responsibilities, skills and the feedback loop into the board’s strategy discussions. In disclosures, a board should describe the company’s approach to risk within the context of current corporate strategy, the process used to set parameters of the company’s risk tolerance, the frequency with which these parameters are reviewed, and whether any limits on risk-taking are imposed on management. Boards should provide sufficient information on their own members so that shareholders can effectively evaluate the full board’s integrity

and qualifications. For instance, boards may disclose member competencies, continuing education programmes, industry and risk management knowledge and experience, and adherence to board ethics standards. Boards are encouraged to communicate openly about any current identified gaps in board competence and their course of action to address these.

20) With respect to the establishment of internal controls and the definition of risk monitoring and management policies, should regulators go beyond disclosure requirements? (i.e., mandatorily require the implementation of audit subcommittees, or set forth the minimum content of such policies, and its periodical review)? Please elaborate on how it is done in your jurisdiction, if applicable.

For most companies, listed or non-listed, large or small, an audit committee is a standard feature and expectation of corporate governance and corporate governance codes. There is also the expectation in most markets that audit committees should be completely or at least majority independent. However apart from the banking sector (where risk committees are also often called for) there is typically no regulatory prescription to form audit committee—though this may feature in listing rules. Responsibility for risk oversight rests with the full board, even if a risk committee or other specialised committees are established. Delegation of responsibility to specialised committees is an important tool in strengthening the board's capacity in overseeing risk. If the board allocates responsibility for risk oversight to one or more committees, it should describe the terms of reference for these bodies in its corporate governance principles and committee charters and ensure that members have sufficient skills in strategy, operations and understanding of the company. The board should determine how the work of its committees is to be coordinated and how it is integrated in the board's discussions on strategy.

21) In your view, how can regulators make a better use of the information produced by external auditors in the enhancement of companies' internal controls? Please provide examples of relevant measures/incentives from your jurisdiction, if applicable.

Both regulators and investors can benefit from enhanced audit reporting, which can greater disclosure of key accounting policy concerns or matters of emphasis. Enhanced reporting for external audit is an important start to improving the value of the audit to shareholders and other stakeholders. The external audit report is addressed to the shareholders but currently, in most jurisdictions, has limited use to shareholders. Regulators may help encourage the effectiveness of risk management systems by asking questions to assess and encourage external audit, internal audit, risk management and compliance working together for better, integrated assurance on risk to the board

22) **The establishment of (i) sound communication channels among corporate bodies, with well-defined and efficient reporting lines, and (ii) a continuous enhancement procedure, are key issues for the effectiveness of corporate internal controls and risk management policies, in order to assure that the policy disclosed by senior management is effectively put into practice.**

Bearing this in mind, what should be the board involvement: (a) in the establishment and assessment of these internal controls, and (b) in the guidance of risk-appetite and internal risk-management structure? Please elaborate on how it is done in your jurisdiction, if applicable.

The board of directors should oversee the establishment and maintenance of an effective system of internal control which should be measured against internationally accepted standards of internal audit and tested periodically for its adequacy. Where an internal audit function has not been established, full reasons for this should be disclosed in the annual report, as well as an explanation of how adequate assurance of the effectiveness of the system of internal controls has been obtained.

23) **Should regulators mandatorily require the issuing of integrated reporting, addressing sustainability and social responsibility? Please elaborate on how it is done in your jurisdiction, if applicable.**

ICGN strongly advocates "integrated thinking" by companies, including reporting on material environmental, social and governance (ESG) factors—and we believe that integrated reporting should be encouraged, though not necessarily required.

An integrated report that puts historical performance into context should be published and portray the risks, opportunities and prospects for the company in the future, helping investors and stakeholders understand a company's strategic objectives and its progress towards meeting them. Such disclosures should:

- be linked to the company's business model;
- be genuinely informative and include forward-looking elements where this will enhance understanding;
- describe the company's strategy, and associated risks and opportunities, and explain the board's role in assessing and overseeing strategy and the management of risks and opportunities;
- be accessible and appropriately integrated with other information that enables investors to obtain a picture of the whole company;
- include environmental, social and governance related information that is material to the company's strategy and performance;
- use key performance indicators that are linked to strategy and facilitate comparisons;

- use objective metrics where they apply and evidence-based estimates where they do not; and
- be strengthened where possible by independent assurance that is carried out annually having regard to established disclosure standards.

24) Should regulators mandatorily require the issuing of reports on the board role with regards to cyber and information security and data integrity? Please elaborate on how it is done in your jurisdiction, if applicable.

ICGN believes that cyber and information security pose key risks to companies and their investors, and that it is the responsibility of the board to address these risks and assume accountability for their oversight. This should normally be part of standard risk reporting rather than a standalone reporting requirement.

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