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# **CHANGING PERSPECTIVES IN CORPORATE GOVERNANCE**

**IOSCO IARC/ COSRA MEETING  
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## IOSCO Objectives and Principles

- Standard Setting Body for securities regulation
- Objectives:
  - Investor protection
  - Fair, efficient and transparent markets
  - Reduction of systemic risk
- New IOSCO Principles:
  - Principle 8: Conflicts of interest and misalignment of incentives should be avoided, eliminated, disclosed or otherwise managed
  - Principle 31: Market intermediaries to establish an internal compliance and ensure proper risk management
- Good corporate governance goes towards meeting IOSCO Objectives.

## What is Corporate Governance?

- **OECD Definition:**

*“Procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making”;*

Corporate governance also provides the structure through which the objectives (i.e. strategy) of the company are set, and the means of obtaining those objectives and monitoring performance are determined.

## Principles of Corporate Governance

- At the practical level, good governance embodies the following principles:
  - fostering and adhering to high ethical standards in every decision and every initiative;
  - ensuring boards are comprised of appropriately experienced, independent, skilled, knowledgeable directors;
  - ensuring remuneration policies are transparent, reasonable and fair;
  - ensuring risks are clearly identified and properly managed; and
  - ensuring directors are confident of the quality and independence of auditing processes.
- OECD Principles adopted in 1999 and revised in 2004, outline the basis of an effective corporate governance framework

## Elements of Corporate Governance

- *Board:*
  - Responsible for the governance of the company.
  - Setting strategic aims, leadership, management of business, monitoring of possible conflicts of interests, reporting to shareholders
  - Board's actions subject to laws, regulations and shareholders in general meeting
- *Shareholders:* appoint directors and auditors and satisfy themselves re governance structure
- For Financial Institutions in particular,
  - Boards play the pivotal role through control of 3 factors: choice of strategy; assessment of risk taking, and the assurance that necessary talent is in place to implement the strategy (including CEO)
  - Risk governance and internal controls. Those accountable for key risk policies to be empowered to put the brakes on the firm's risk taking, but also to play a critical role in enabling the firm to conduct well-managed, profitable risk-taking

## **IOSCO Work on Corp. Governance** **([www.iosco.org/library](http://www.iosco.org/library))**

- TC and EMC Task Forces on Corporate Governance
- Role of Corp Gov in Monitoring Auditor's Independence (02)
- Board Independence of Listed Companies (07)
- Corp. Governance Practices in Emg Markets (07)
- Protection of minority shareholders in listed issuers (09)
- Strengthening Capital Mkts against Financial Frauds (05)- Corp. Gov, Auditor oversight, disclosure
- Issues arising from Exchange evolution(06)
- Examination of Governance for CIS (06)
- Issuer Internal Control requirements (06)
- Causes, effects and reg. implications of fin and eco. Turbulence in emerging markets (99)
- Joint Forum: Core Principles- cross sectoral comparison (01) "Similar CG reqmnts apply; these also apply to issuers in the securities sector"
- Principles for Periodic Disclosure by listed companies (2010)



## The Crisis and Corporate Governance

- State injections of equity, takeover of failed institutions, exceptional liquidity support arrangements, now materially tougher capital requirements
- Excessive risk taking – governance failures
- Well-run companies were capable of making catastrophic misjudgements
- Risk management was not properly overseen, monitored and reviewed and boards were not discussing the company's risk appetite
- Remuneration and incentivisation were not aligned with shareholders' objectives
- Disclosure failed to inform stakeholders sufficiently
- In many cases, self interests were put ahead of the company's interests.

## **Corporate Governance matters- even more now!**

- Securities markets will play an important role in financing the economy
- Confidence and Trust in markets need to be restored for them to function
- Corporate governance is a vital plank in rebuilding trust and in investor protection
- Financial regulation cannot alone assure performance – better governance also needed
- Right balance needed to ensure safety and soundness without cramping enterprise
- Issues relate more to patterns of behaviour than to organisation: “challenge” step needed
- Board level engagement in risk oversight to be materially increased.



## IOSCO's recent work referring to Corp Governance

- Principles for Periodic Disclosure of Listed Entities (2010):
  - *Disclosure of Director and Senior Management compensation and risk management practices*- compensation system, decision making; internal controls and framework to assess effectiveness
  - *Corporate Governance disclosure*: directors and senior management, director independence, audit and compensation c'tees, code of ethics
- Principles for FMIs (2012): Principle 2 on Governance
  - Documented governance arrangements: including risk management, internal controls
  - Role and responsibilities of Board to be specified; documented procedures including to address conflicts of interest
  - Skills of members; non executive members
  - Board committees: Risk committee, audit committee, compensation c'tee
  - Board to establish risk management framework including risk tolerance policy, accountability for risk decisions, and address decision making in crises
  - Consider stakeholders' interests (including direct and indirect participants)- through board representation, user committees, and public consultation process

## Corp Governance -Financial Institutions

- Globalized world- investor confidence affected by international events
- Financial institutions are the most globally exposed and interconnected of all industries
- They are also key players in any well-functioning capital market with a global outreach
- Understanding and management of risk and internal controls crucial; also ability to aggregate data
- Complex/opaque structure- Board to understand and ensure that there is no undue or inappropriate complexity
- Compensation issues- FSB principles for sound compensation practices
- Important to incentivise proper behaviour by intermediaries, asset managers, broker-dealers
- Management of conflict of interest
- Proper disclosure including at Point of Sale, complex products
- Disclosure of voting rights record by institutional shareholders

## Corp Governance: agenda for the future

- Better articulation of business case for best practice corporate governance will help...
- ...but focus on directors' duties, responsibilities and potential liabilities is likely to generate heightened awareness of the need to exhibit appropriate boardroom behaviour
- Supervisors to more fully comprehend FI strategies, risk appetite and profile, culture and governance effectiveness
- Implementation of CG principles and Enforcement of conduct of business will be important
- Need for deterrent sanctions

## Some outstanding issues

- Shareholders and short termism?
- Role and involvement of Creditors; appropriate balance?
- Special role of Corporate Governance in SIFIs? Resolvability?
- Corporate governance of Conglomerates

## Conclusion

- Bad corporate governance undermines investor confidence at global level
- Capital markets to play a major role
- Trust and confidence - a paramount necessity
- Corporate governance needed in addition to regulation and supervision to rebuild trust
- What matters is not the form of the governance structure or procedure, but actual behaviour
- Enforcement of the rules is also crucial
- Strong implementation and international peer review important

THANK YOU