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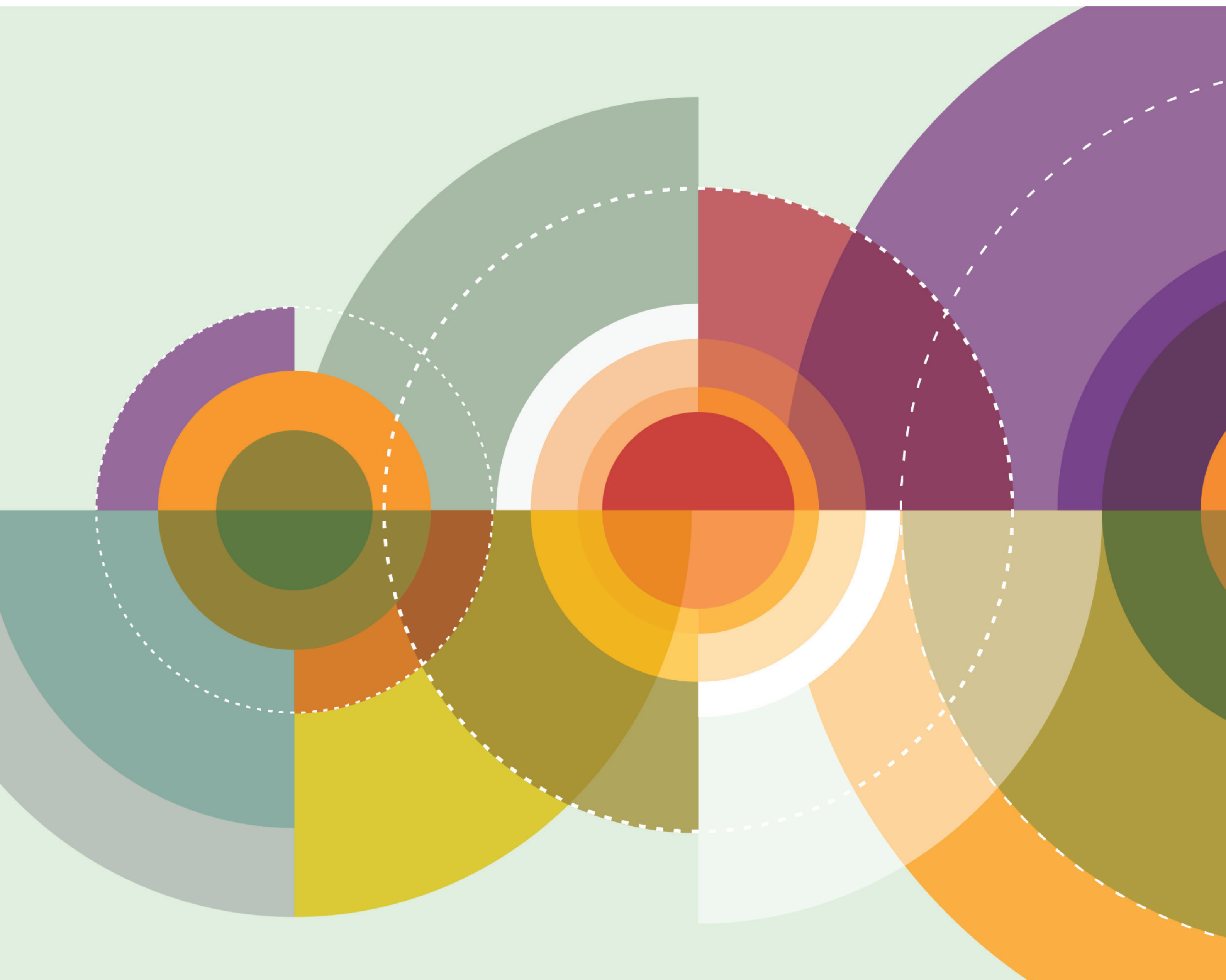
Methodology for Assessing the Implementation of the G20/OECD Principles of Corporate Governance



Methodology for Assessing the Implementation of the G20/OECD Principles of Corporate Governance 2025

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Please cite this publication as:
OECD (2025), *Methodology for Assessing the Implementation of the G20/OECD Principles of Corporate Governance 2025*, OECD Publishing, Paris, https://doi.org/10.1787/80996ea9-en.

ISBN 978-92-64-48683-6 (print)
ISBN 978-92-64-93043-8 (PDF)
ISBN 978-92-64-64672-8 (HTML)

Photo credits: Cover © Andrew Esson/Baseline Arts Ltd.

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Foreword

The G20/OECD Principles of Corporate Governance are the leading international standard for corporate governance. Following their adoption by the OECD Council at Ministerial Level in June 2023 and their endorsement by G20 Leaders in September 2023, the OECD Corporate Governance Committee (Committee) has turned its attention to supporting the Principles' implementation. As one of the Key Standards for Sound Financial Systems adopted by the Financial Stability Board (FSB), the Principles are globally recognised as an important benchmark supporting the improvement of legal, regulatory and institutional frameworks for corporate governance with a view to promoting market confidence and integrity, economic efficiency, sustainable growth, and financial stability across jurisdictions globally.

By providing an updated tool to evaluate and encourage jurisdictions' implementation of the Principles, the Committee is therefore pleased to issue this Methodology for Assessing the Implementation of the G20/OECD Principles of Corporate Governance (Methodology). Together, the Principles and Methodology form the basis for voluntary self-assessments by jurisdictions, as well as for OECD corporate governance assessments, including for jurisdictions seeking accession to the OECD. This revised Methodology has also benefited from the input of the World Bank and International Monetary Fund, with a view towards their use for corporate governance assessments under the auspices of their Review of Observance of Standards and Codes (ROSC) and Financial Sector Assessment Programme (FSAP). The Methodology may also be used to support more targeted reviews on selected corporate governance priorities. The 2025 revision of the Methodology takes account of all recent changes to the Principles and includes significant updates to its structure and content to facilitate more effective assessments.

This latest update to the Methodology was prepared by the Corporate Governance Unit of the Capital Markets and Financial Institutions Division within the OECD Directorate for Financial and Enterprise Affairs. The team included Valentina Cociancich, Thomas Dannequin, Caio De Oliveira, Fianna Jurdant, Tiziana Londero, Alejandra Medina, and Akiko Shintani with additional contributions from Sebastian Abudoj, Takashi Sudo, and Yunus Emre Yildirim, under the supervision of Serdar Çelik, Head of Division, and Daniel Blume, Head of the Corporate Governance Unit. The publishing and communication process was supported by Greta Gabbarini and Liv Gudmundson, who provided editorial guidance and expertise in communications.

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A. Methodological issues and procedures

Introduction

This update of the Methodology for Assessing the Implementation of the G20/OECD Principles of Corporate Governance follows the 2023 revision of the G20/OECD Principles of Corporate Governance (hereafter "The Principles or G20/OECD Principles") (OECD, 2023[1]). Together, the Principles and the Methodology form the basis for voluntary self-assessments by interested bodies and jurisdictions, for assessments undertaken by the World Bank/ International Monetary Fund (IMF) either in the form of a Review of Observance of Standards and Codes (ROSC) or as part of the Financial Sector Assessment Programme (FSAP), and for OECD corporate governance assessments, including in the context of accession to the OECD by candidate jurisdictions. The G20/OECD Principles have been designated by the Financial Stability Board as a Key Standard for Sound Financial Systems. The Methodology supports the Principles by explaining how to assess their implementation.

The use and scope of the Methodology

The Methodology is intended to underpin an assessment of the implementation of the Principles in a jurisdiction and to provide a framework for policy discussions. It does not create any new Principles or different benchmarks. The ultimate purpose of an assessment is to identify the nature and extent of specific strengths and weaknesses in corporate governance, and thereby support policy dialogue that may identify reform priorities leading to the improvement of corporate governance and economic performance. Since the Principles are concerned in part with company law, securities regulation and the enforcement/legal system, the term "jurisdiction" rather than country is used in the Methodology. Reviewers should note that because sometimes a country may have several different geographical jurisdictions with separate regulatory frameworks, a country level assessment, if indeed this is meaningful, would need to take this factor fully into account.

Reflecting the Principles, the Methodology places emphasis on "outcomes" and, therefore, on "functional equivalence". The latter means that there are many different ways to achieve the "outcomes" advocated by the Principles, including through institutions, laws and companies' internal rules. Thus, it is recognised in the introduction to the Principles ("About the Principles") that implementation needs to be adapted to national circumstances and take into account jurisdiction-specific economic, legal, and cultural differences. For example, the protection and enforcement of minority shareholder rights might be achieved via private arrangements, such as by majority shareholders agreeing to restrict the use of their powers to appoint the whole board, special investigation procedures and/or class enforcement procedures. These alternatives are often deeply rooted in legal and social traditions.

The criteria to judge whether a principle has been implemented, therefore, have to be selected in a way that does not imply a value judgement about the "means", but rather about the effectiveness and efficiency

of current arrangements in terms of achieving the outcome. The Methodology does, however, recognise that the relative costs and benefits of alternative "means" of implementation might vary over time as, *inter alia*, the composition of publicly traded companies and the structure of ownership and control in the jurisdiction evolves. The need for a dynamic perspective for policy dialogue is thereby recognised. To underpin policy dialogue, the Methodology, like the Principles, treats jurisdictions consistently, despite their widely different institutional structures and traditions. This feature is intended to facilitate a discussion about different remedies for similar problems and the transferability of experience between jurisdictions.

The Methodology does not, however, encourage any summary ranking of jurisdictions against each other or the construction of a single, overall rating. Rather, it is intended to assess jurisdictions qualitatively against what they could and should achieve in relation to the Principles, and to provide a framework for identifying policy options to improve corporate governance.

This Methodology aims to provide the tools for assessors to carry out comprehensive assessments against the Principles. These may be voluntary self-assessments, carried out for example in the context of a jurisdiction's consideration of becoming an Adherent to the Principles, or to support required assessments as part of a jurisdiction's accession process to become a Member of the OECD. The Methodology also serves as a basis for other formal reviews such as ROSCs and FSAPs by the World Bank and IMF, respectively.

The Methodology can also be used to carry out more focused reviews on certain corporate governance topics, which may take into consideration elements of all of the six chapters of the Principles or be more specific to one of the chapters. Focused reviews on certain topics of a corporate governance framework against the Principles (or a subset thereof) should always be accompanied by a review of the corporate governance landscape (Part B of the Methodology). The corporate governance landscape the elements of which are described in Part B provides necessary background information to understand the institutional and legal framework for corporate governance and should be regarded as a necessary pre-condition to analyse and assess more specific topics of corporate governance.

Focused reviews may cover topics such as: protection and enforcement of minority shareholder rights, sustainability, access to finance and the development of capital markets, corporate governance of company groups, and the functioning of corporate governance codes. These reviews may be conducted by chapter(s) of the Principles or by thematic areas across chapters. In both cases, the cross-references provided following each principle and sub-principle in Part C may be a useful tool for assessors to understand which other principles are complementary to form an assessment on a certain topic.

How to assess outcomes

Making an informed judgement

The Principles are outcome-oriented. What is being assessed to determine the implementation of individual principles is a combination of the legal framework and other implementation measures, enforcement, corporate practices, and the functioning of markets. The corporate governance framework comprises legislation, regulation, standards including as defined via case law or judicial decisions, codes and principles and business practices. They are the result of a jurisdiction's specific circumstances, history and tradition so that the desirable mix will therefore vary from jurisdiction to jurisdiction. For example, forming an assessment about whether boards are diligent is likely to depend on judgements about the implementation of other principles, such as those covering shareholder rights, transparency and the efficacy of the enforcement mechanism. An assessment about whether the Principles are implemented in a jurisdiction is therefore necessarily a matter of informed judgement based on a variety of sources of information.

The fact that the Methodology is focused on jurisdictions and not on individual companies also gives rise to some specific challenges. As companies in a jurisdiction usually vary in their own governance practices, there is a question as to how widespread a practice should be, or how important any abuse should be, for the jurisdiction as a whole to be considered as implementing or not implementing the Principles. It is difficult to set out clear-cut guidelines and checklists to cover such a situation. Perhaps the best approach to assessing implementation therefore is to rely on "a reasonable assessor" or "reasonable observer" type procedure, the practicalities of which are developed further in the following sub-section.

The comprehensive scope of the Principles means that individual principles might often be closely related to others, the outcome being similar but looking at the issue from a different angle. This implies that informed judgements about a given principle might at least be checked for consistency or complementarity with the judgement for other closely related principles. To aid the reviewer and to restrict the room for *ad hoc* judgement in an individual case, the Methodology therefore includes a number of cross references to related principles that form the basis for a consistency/complementarity check. Furthermore, the Principles make references to a number of other OECD and non-OECD instruments. Where applicable, reviewers may wish to take into account relevant reporting mechanisms associated with these instruments.

An assessment must be sufficiently in-depth to allow a judgement about whether a principle is fulfilled in practice, not just in concept. This will involve examining both implementation and enforcement issues, addressed in further detail below.

A qualitative assessment scheme

The approach of the Methodology to making an assessment is principally qualitative: although the Methodology may take into account certain quantitative measures (e.g. the structure of company pyramids), the assessment cannot be reduced to a quantitative score or set of quantitative scores. No use is made of indicators based on the number of "yes" and "no" answers because the importance of some responses will be different across jurisdictions, depending on such variables as company law, ownership concentration and company groups. The responses to the essential criteria for each principle and sub-principle may help the assessor in forming the basis of a fully implemented rating. However, counting "yes" and "no" answers is dependent on agreement about the number of elements judged to be important (even if the indicator is expressed as a percentage) and the relationship between the individual questions. This does not preclude the development of statistical indicators once there is consensus about what is to be measured and how, and in the context of functional equivalence.

To support the assessment process, the Methodology follows an assessment scale similar to that used by the other standard setters of FSB Key Standards and by the World Bank, which classify according to observed/implemented, broadly observed/implemented, partly observed/implemented, and not observed/implemented. The classification also reflects a judgement about the effectiveness of enforcement and the operation of markets. For each principle, "essential criteria" are specified that seek to make the principle's outcome more specific and easier to verify by a reviewer for effective evaluation of implementation, while preserving functional equivalence. These essential criteria have been formulated in the form of questions in order to make it easier for an assessor (or self-assessor) to focus on the information and questions most necessary to address to help them form a judgement. However, the essential criteria are an aid to making an assessment and are not a substitute for a careful judgement about actual outcomes. A summary of the assessment scheme and guidance on the application of its criteria is provided in Table 1.

For the purpose of policy dialogue, the assessment outcome may not be as important as the reasons advanced by the reviewer. This is particularly so for the classification "partly implemented". In particular, it is important for the reviewer to note whether partial implementation predominantly reflects an inadequate legal framework, poor enforcement by the authorities, lack of or inefficient private redress mechanisms, weak market mechanisms or limited private sector observance, or a combination of some or all these. In

some cases, the legal and regulatory framework might be so new that the influence on corporate practices cannot yet be properly assessed. In other cases, the essential criteria associated with a principle involve the assessment of complex and specialised topics (e.g. the operation of central securities depositories, creditor rights) that might stretch the resources of a reviewer. Nevertheless, a reviewer is still expected to form a reasoned judgement to the extent feasible after consulting with relevant specialists, while noting the uncertainty and preliminary nature of the assessment. To enhance its use as an analytical tool, it is also important for the reviewer to take note of any trend and current and proposed developments concerning each principle, although they should not form part of the assessment. Such information is essential for prioritising policy recommendations and when considering the potential need for complementary policy actions.

Table 1. Summary of assessment scheme

Fully Implemented	A Fully Implemented assessment is likely appropriate when all of the applicable essential criteria are implemented in all material respects. However, the essential criteria are an aid to making an assessment and are not a substitute for a careful judgement about actual outcomes. Where the essential criteria refer to standards (i.e. practices that should be required, encouraged (e.g. through code recommendations or market-based incentives) or, conversely, prohibited or discouraged), all material aspects of the standards are present. Where the essential criteria refer to corporate governance practices, the relevant practices are widespread. Where the essential criteria refer to enforcement mechanisms, there are adequate, effective enforcement mechanisms. Where the essential criteria refer to remedies, there are adequate, effective and accessible remedies.
Broadly Implemented	A Broadly Implemented assessment is likely appropriate where one or more of the applicable essential criteria are less than fully implemented in all material respects, but, at a minimum: • all of the applicable essential criteria are implemented to some extent; • the core elements of the standards are present (e.g. general standards may be in place although some of the specific details may be missing); and • incentives and/or disciplinary forces are operating with some effect to encourage at least a majority of market participants, including significant companies, to adopt the recommended practices.
Partly Implemented	A Partly Implemented assessment is likely appropriate in the following situations: • One or more core elements of the standards described in a minority of the applicable essential criteria are missing, but the other applicable essential criteria are fully or broadly implemented in all material respects (including those aspects of the essential criteria relating to corporate governance practices, enforcement mechanisms and remedies); • The core elements of the standards described in all of the applicable essential criteria are present, but incentives and/or disciplinary forces are not operating effectively to encourage at least a significant minority of market participants to adopt the recommended practices; or • The core elements of the standards described in all of the applicable essential criteria are present, but implementation levels are low because some or all of the standards are new, it is too early to expect high levels of implementation and it appears that the reason for low implementation levels is the newness of the standards (rather than other factors, such as low incentives to adopt the standards).
Not Implemented	A Not Implemented assessment is likely appropriate where there are major shortcomings, for example where: • The core elements of the standards in a majority of the applicable essential criteria are not present; and/or • Incentives and/or disciplinary forces are not operating effectively to encourage at least a significant minority of market participants to adopt the recommended practices.
Not Applicable	A Not Applicable assessment is appropriate where a Principle (or one of the essential criteria) does not apply due to structural, legal or institutional features (e.g. institutional investors acting in a fiduciary capacity may not exist).

Many principles are broken down into sub-principles. Assessments against each principle and its sub-principle(s) are necessary to form a judgement on the implementation (Table 1). Where the reviewer considers it important to form a judgement about the principle as a whole, in the absence of good arguments to the contrary, the overall judgement should take into account the assessment against the weakest sub-principle. For example, with respect to Principle IV.A., there might be adequate implementation of sub-Principle IV.A.1. regarding financial disclosure, but if there is inadequate disclosure about major shareholdings, including beneficial ownership and voting rights (sub-Principle IV.A.4.), the principle should not be considered as fully implemented, but rather as broadly implemented. The more detailed assessment is more useful than an overall assessment since deficiencies are clearly identified

and an implicit weighting scheme on the part of the reviewer is avoided at the first stage of the assessment, and made transparent in the summary stage.

Implementation and enforcement

Determining whether the Principles are implemented in a jurisdiction implies a holistic evaluation of different elements, which, depending on the principle and/or sub-principle may encompass legal requirements, soft law and corporate governance code recommendations, other corporate governance guidelines, corporate disclosures, reporting to and data collected by supervisory authorities and self-regulatory organisations (SROs), as well as evidence of implementation or non-implementation. This implies that the assessor has to evaluate whether the recommendations of the Principles are implemented in practice.

In assessing implementation, some aspects of the Principles will be set out in law and regulations, but other elements of the corporate governance framework may also encourage adoption of certain practices such as guidelines, self-regulation, instructions and other documents, as well as more intangible market pressures that may be exerted through shareholder engagement, proxy advisory guidance, or trading of shares. A mandatory company law system might appear to ease the task of the reviewer in that all companies must adopt the same arrangements. However, a principle may also be considered implemented if it is effectively encouraged through soft law code recommendations, industry guidance or other market pressures, and if information concerning market practices indicates that the practice is widespread. While not repeated explicitly as an essential criterion for each principle, the reviewer must still form an overall judgement about whether a practice recommended by a principle is widespread regardless of whether it is mandated, and when mandated, whether the mandated features are complied with and consistent with the Principles. In more enabling company law systems, the reviewer will need to form a judgement about the balance of actual practices and whether these might lead to the Principles not being implemented.

Additionally, corporate governance is intrinsically related to enforcement mechanisms, as governance frameworks are not effective without a solid enforcement environment. The reviewer should consider both public and private elements of enforcement (Table 2). Jurisdictions apply a mix of the two elements and differ in the relative weight given to each. Hence a fair and full picture of a system's effectiveness and robustness requires that the functioning of both approaches is understood.

Enforcement is here taken to mean actions taken by organs of the state such as the securities regulator, public prosecutor, company registrar, etc., as well as by institutions exercising devolved authority such as SROs. Effective enforcement requires the availability of effective, proportionate and dissuasive sanctions in the event of non-compliance with company law, securities law, listing rules and other related regulations.

Enforcement can also be exercised through effective means of redress for shareholders and stakeholders in courts as well as through alternative dispute resolution (ADR) mechanisms. Effective mechanisms for challenging corporate actions could include, among others, court proceedings, administrative proceedings and arbitration, which is used in some jurisdictions as an alternative dispute resolution mechanism. Effective remedies could include, among others, enjoining, unwinding or mandating corporate actions, fines or penalties, damages or restitutionary awards, and enforceable rights to have one's shares purchased at a fair value determined without giving effect to the corporate action that the shareholders have challenged. In some jurisdictions, individual shareholders have extensive rights of redress, while in others such rights might reside with the general meeting of shareholders. For the reviewer, it is important to form a judgement about how effectively these rights can be exercised. Judging whether enforcement is effective or deficient in a given situation will require not only an examination of the record of enforcement, the fines and redress actually imposed, and the number of cases dismissed on procedural grounds at lower courts, but also understanding the viewpoint of investors in terms of the time, cost, competence, reliability and independence of the judiciary and of courts competent to adjudicate the jurisdiction's corporate

disputes. Investors with experience of other systems might be consulted as they are likely to be sensitive to procedural difficulties and the costs of enforcement activities. An overall judgement on the effectiveness of enforcement should also take into consideration available data on both public and private enforcement actions, such as number of cases involving listed companies, length of time taken to resolve disputes, average amounts of sanctions in different categories, recourse to ADR mechanisms, etc.

Table 2. Public and private enforcement mechanisms

Public enforcement		Private enforcement mechanisms	
Mechanism	Actor	Mechanism	Actor
Sanctions for non-compliance with market rules and listing requirements or other actions addressing company governance (e.g. issuing rulings on the validity of an AGM, ordering an issuer to take remedial action, issuing warnings, etc.)	Securities regulator Public prosecutor Stock exchange SROs	Civil lawsuits (shareholder complaints, derivative lawsuits, class actions)	Judiciary and courts
		ADR mechanisms	ADR centres (arbitration, mediation, conciliation)

Different enforcement mechanisms should be evaluated as to how they complement each other. The reviewer should form an understanding of the ability to make use of courts as well as ADR mechanisms. In practice, a reviewer will have to arrive at a careful judgement on whether the strengths and weaknesses of one method of enforcement outweigh those of another method, and whether market forces are strong enough by themselves to reduce the need for supporting measures. For example, the question that might have to be asked is whether in a jurisdiction with weak courts, the enforcement activities of an ADR mechanism or of the regulator constitute an effective alternative. Enforcement might also not be considered as effective if, for example, rights of enforcement reside only with a regulator or company registrar who may not have the right incentives or resources to enforce the law or when seeking redress through courts is not time and/or cost efficient for shareholders.

An assessment of essential criteria for the majority of principles and sub-principles should generally also take into account the effectiveness of enforcement. However, to avoid repeating the same essential criteria throughout, it is important to clarify that this Methodology does not list an essential criterion concerning the effectiveness of enforcement for each principle and sub-principle. While enforcement is relevant for the assessment of most principles, it would likely overburden the assessor to seek enforcement data and assess effectiveness with respect to each individual principle. Nevertheless, at a more general level, a reviewer should consider whether there are means for effective enforcement even when it is not underlined as one of the essential criteria for a particular principle. For principles for which enforcement represents a particularly essential element for their implementation, an explicit essential criterion is included to reinforce the importance of specifically assessing the adequacy, effectiveness and accessibility of enforcement mechanisms. These are: Principle I.B., Principle I.C., Principle I.E., Principle II.F., Principle II.G., Principle III.E., sub-Principle IV.A.7., Principle IV.B., Principle IV.C., Principle V.A., and sub-Principles of VI.D. (Table 3).

It is also necessary to form a judgement about the strength and effectiveness of market forces in promoting implementation of the Principles. Market forces will vary considerably from jurisdiction to jurisdiction and not only on account of the legal/regulatory environment, which may be more or less market friendly. For example, disclosure about corporate governance arrangements might be effectively implemented by the market itself in systems with capital markets that are attuned to examining such disclosures and pricing company shares accordingly. Effective shareholder rights might stimulate companies to adopt policies and bylaws that result in improved corporate governance standards. However, relying on market forces might be entirely ineffective in systems characterised by concentrated ownership and shallow capital markets, so that other enforcement mechanisms might be required, including, for example, monitoring by the capital markets regulator of corporate governance reports and practices.

Table 3. Key principles for assessing enforcement

Key principles	Issue covered
Principle I.B.	Transparency and enforceability of the corporate governance framework
Principle I.C.	Division of institutional responsibilities for corporate governance
Principle I.E.	Institutional framework for corporate governance
Principle II.F.	Managing related party transactions and conflicts of interest
Principle II.G.	Minority shareholders' redress
Principles III.E.	Enforcement of insider trading
Sub-Principle IV.A.7.	Disclosure of related party transactions
Principle IV.B.	Disclosure in accordance with internationally recognised accounting and disclosure standards
Principle IV.C.	External audit
Principle V.A.	Board fiduciary duties
Sub-Principles of VI.D.	Sub-principles related to the enforcement of stakeholder rights

The reviewer and the assessment process

The process of assessing each of the principles requires a judgemental weighting of numerous elements that only qualified assessors with practical experience can provide. Many reviewers of standards seek to ensure both this and inter-jurisdiction consistency by including in their teams members with broad international experience. Under all circumstances, in-depth consultations with individuals and constituencies with first-hand experience of the assessed jurisdiction is an absolute necessity and may, in addition to relevant authorities, also include market participants, such as accountants/auditors, board members and investors, as well as researchers, academics, rating agencies, and other relevant stakeholders. Moreover, in view of the complexity of corporate governance systems, an iterative process between the reviewer and the authorities and other parties is required in order to deepen the basis of the assessment and a consideration of policy priorities. The assessor should have free access to a range of information from different parties. The information necessary to carry out an assessment may include not only published information, such as laws, regulations and guidelines, but also internal information, provided by supervisory and regulatory authorities.

It is valuable to enhance national debate and national expertise with experience from other jurisdictions. This process can take several forms, one end of the spectrum being full peer reviews, the other being a policy dialogue hosted by international fora, such as the OECD Corporate Governance Committee. The OECD Corporate Governance Factbook ("Factbook"), published every two years, can also be used as a reference for common practices in OECD, G20 and FSB jurisdictions (OECD, 2023[2]). Certain widespread practices across these jurisdictions are cited under principles and sub-principles to provide a reviewer with relevant examples. An assessment should not be seen as a static exercise but should form the basis for a policy dialogue that can identify reform priorities and support the reform process. In its other activities, the OECD uses other methods such as policy dialogue of regional corporate governance roundtables, thematic and country-focused assessments to provide a basis for consideration of corporate governance reform options, and follow-up seminars and discussions in the jurisdictions concerned. The World Bank might also include technical assistance and training in any follow-up to a ROSC.

The structure of this Methodology

Part B of the Methodology discusses the various kinds of legal, regulatory and institutional information and data that are essential for putting the assessment into a national/jurisdictional context by achieving a solid understanding of the corporate governance landscape.

Part C follows the structure of the G20/OECD Principles and is divided into the six chapters of the Principles: I) Ensuring the basis for an effective corporate governance framework; II) The rights and equitable treatment of shareholders and key ownership functions; III) Institutional investors, stock markets, and other intermediaries; IV) Disclosure and transparency; V) The responsibilities of the board; and VI) Sustainability and resilience.

Each chapter is headed by a single principle that appears in bold italics and is followed by a number of supporting principles and their sub-principles in bold. The Principles are supplemented by annotations intended to help readers understand the rationale of the principles and sub-principles. An example is provided in Table 4. The annotations may also contain descriptions of dominant or emerging trends and offer examples of implementation methods that may be useful in making the Principles operational and that may be further expanded on through the Methodology.

Table 4. Example of the structure of the Principles

Examples from the Principles	Classification
The corporate governance framework should promote transparent and fair markets, and the efficient allocation of resources. It should be consistent with the rule of law and support effective supervision and enforcement.	Principle opening Chapter I
II.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.	Principle
II.C.1. Shareholders should be furnished with sufficient and timely information concerning the date, format, location and agenda of general meetings, as well as fully detailed and timely information regarding the issues to be decided at the meeting. ***II.C.2. Processes, format 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.***	Sub-Principles
The right to participate in general shareholder meetings is a fundamental 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 have charged fees for voting. Other potential impediments include prohibitions on proxy voting, requiring personal attendance at general shareholder meetings to vote, bundling of unrelated resolutions, holding the meeting in a remote location, and allowing voting by show of hands only. Still other procedures may make it practically impossible to exercise ownership rights. Voting materials may be sent too close to the time of general shareholder meetings to allow investors adequate time for reflection and consultation. Many companies 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 and the corporate governance framework should facilitate the use of electronic voting in absentia, including the electronic distribution of proxy materials and reliable vote confirmation systems. In jurisdictions where private enforcement is weak, regulators should be in a position to curb unfair voting practices.	Annotations

The treatment of each chapter of the Principles follows a common pattern and comprises two main parts:

- Introduction
- Issues and assessment criteria

The Introduction briefly discusses the general understanding of the overarching principle that opens each chapter of the Principles. Building on the annotations to the principle, the introduction also discusses special concerns and aspects that should be taken into account when considering implementation of the principle. The main section of each chapter in Part C is the Issues and assessment criteria, where each individual principle and its sub-principle(s) are treated under a separate heading. Related principles and sub-principles that are considered relevant for a comprehensive assessment against a certain principle or sub-principle are also noted under each heading, and can be used as a consistency check or reference to understand complementarities between different principles. After briefly outlining the intent of the principle or sub-principle, the following section (Likely practices to be examined) briefly discusses the actual situation and practices that a reviewer might confront. Guidance is given as to how actual situations might be assessed against the outcome recommended by the principle/sub-principle. In line with the discussion

and the intent of the principle, an associated set of essential criteria are specified, with specific questions a reviewer may ask to determine whether such criteria are met and if not, what elements may be missing to determine the level of implementation (as set out in Table 1).

Forming policy options and recommendations

This section deals with how all the chapters of the Principles and associated assessments should be drawn together in a final assessment, including a discussion of policy priorities and specific measures that might be considered. This section draws heavily on Chapter I of the Principles, "Ensuring the basis for an effective corporate governance framework", which is discussed in Part C of this Methodology. The assessment would cover not just the assessed strengths and weaknesses of individual principles and sub-principles but also indicate how they serve to evaluate the functioning and efficiency of the overall corporate governance framework. The emphasis is on how the corporate governance framework actually functions as a system: the whole can be greater than the sum of the parts which is important to take into account when considering policy priorities. In discussing policy priorities, the assessment also needs to consider the presence of complementarities whereby some policy measures might be ineffective until accompanied by other initiatives, either by companies or by the authorities.

The format of a review is open to the choice of the user of the Methodology. However, generally reviews are in written form and, at a minimum, include a short executive summary including a summary of key findings and recommendations. The main body of the accompanying documentation would also include a table summarising the assessments of each principle and sub-principle. It should be noted that the World Bank's ROSCs follow a specific format. If the intention of the user is to request a ROSC assessment, the World Bank should be consulted about their requirements.

The concern in this section is with the content and process of deriving conclusions and establishing policy options and priorities rather than the format of a written report. Three inter-related elements need to be taken into consideration and presented in a transparent manner by the reviewer: assessing the corporate governance landscape; summarising what has been learnt from the assessment of individual principles; forming a judgement about the resulting policy implications and priorities.

Forming an assessment about policy options and priorities

The corporate governance landscape

The reviewer needs to identify the nature and extent of corporate governance strengths and weaknesses in the jurisdiction by considering the corporate structure, current ownership and control systems, and how these have become established and have evolved in recent years. The elements underlying a certain corporate governance landscape might include recent privatisations, past industrial and trade policies, policy measures in response to emergency situations (e.g. a pandemic) and a history of uncertainty due to, for example, property confiscations. Current forces for change also need to be considered, including international agreements that have implications for corporate law. To maintain transparency of the review process, the legal, regulatory and enforcement structures would be considered and the lessons drawn from any recent corporate governance failure discussed. In short, this element of the review process would identify how the major corporate governance issues (i.e. agency costs) are arising and why the situation, covered in more detail as part of the assessment of some principles, has arisen.

Summarising what has been learnt from the assessment of implementation

The review needs to provide a summary of assessments for each principle and sub-principle together with the main reasons for the assessment (e.g. inadequate laws, poor enforcement, not a widespread company

practice). In some cases it will be useful to specify which essential criterion is the primary reason of the assessment. Such a comprehensive process serves to make clear that the jurisdiction has been reviewed against the Principles as a whole, and minimise any chance of overlooking important elements. Not all principles need to be covered in the same detail depending on the judgement about their importance, considering also the objective of the assessment and the corporate governance concerns that need to be considered in a jurisdiction. The complementarity between principles would also be considered. For example, the effective exercise of shareholder rights is related to assessments about transparency and the functioning of the board. The review would also consider those areas where the jurisdiction is judged to have broadly or fully implemented the Principles, and indeed might have gone beyond the recommendations of the Principles and is now developing "good practices". Areas of strength as well as weaknesses would thus be taken into account. Detailed assessments for each principle and sub-principle and the corresponding essential criteria may or may not form part of any report depending in part on whether confidential information has been used in forming an assessment of an essential criterion. However, they are an essential input for the reviewer in forming a judgement about priorities and identifying recommendations to enhance implementation of the Principles.

Forming a judgement about policy implications and priorities to strengthen implementation of the Principles

This part of the process involves moving from individual assessments of each principle to developing policy options and priorities. For the reviewer, a judgement that a principle or sub-principle is only partly or even not implemented carries by itself little information about what measures might be required, and about the relative importance of each weakness. Chapter I of the Principles offers important guidance to the reviewer in this situation. The reviewer should, after taking into account the assessment of all the principles of Chapters I-VI, form a judgement about where and how corporate governance weaknesses are likely to impact on overarching objectives of promoting corporate access to finance, ensuring the protection of investors and supporting the sustainability and resilience of corporations. It will also be important to assess how such weaknesses may impact on overall economic growth and stability and the promotion of transparent and fair markets. Potential policy options and priorities should be formed with due regard to the interaction with other aspects of the corporate governance framework and the likely cost/benefit relation or overall impact, emphasising first those measures with the greatest likely benefits and the lowest likely costs, both direct and indirect, including any relevant considerations about benefits/costs over time. This distinction should not be confused with the division between short term and long term. For example, reforming a failed, unfair, inefficient or biased judiciary and court system might take a long time to be effective, but should nevertheless be undertaken as a priority if the regulatory impact promises to be great. However, the lesson is that other measures taken in the meantime should not be grounded on the assumption that the court system might function well anytime soon.

Two further examples are useful to illustrate the process of forming options and priorities. An initiative to increase the flexibility of companies with respect to financing and decision-making by boards might be judged a positive development in line with broader objectives of the Principles. However, seen from a systems-wide perspective, this judgement might be misleading and depend on a number of other factors. In a situation of concentrated ownership, strong board control of shareholder meetings and poor minority protection, such an increase in flexibility might actually result in a deterioration of corporate governance standards which may weaken shareholder confidence in the jurisdiction and thereby damage corporate access to finance. The methodology outlined in Principle I.A. calls for the reviewer to focus attention on where the agency costs can occur and the existence of complementarities. In the case where the reviewer considers that private benefits of control are the issue, the focus will need to be on strengthening minority rights starting with the most cost/benefit efficient measures. This is where the reviewer needs to move from identifying broad priorities to considering policy options.

In the case of minority rights, improved transparency is one option together with clearly defining and, if necessary, widening the responsibilities of the board. At the other end of the cost/benefit scale would be majority-of-the-minority approval for related party transactions and the ability of minority shareholders with only a low threshold of votes to call a meeting of shareholders or to initiate litigation on an individual shareholder basis. These latter measures have a potential cost in terms of reduced entrepreneurial flexibility, but the benefits might also be great if the initial situation is highly distorted. Complementarities are an important factor. In this example, the lack of active capital markets or means of either public or private enforcement might make increased transparency a not very effective response; the corporate landscape and existing institutions need to be considered. On the other hand, where capital markets are active and enforcement is recognised as an obstacle, increased transparency mighty prove highly effective.

In presenting a range of policy options, the reviewer might also refer to the experience in other jurisdictions. However, the transferability of experiences from other jurisdictions would need to be carefully considered, including whether required complementarities (e.g. particular institutions) are present in the current corporate governance framework. The principle of functional equivalence needs to be part of the review process.

Principle I.E. addressing the role of supervisory, regulatory and enforcement authorities is particularly important for an overall assessment, aiding the reviewer to avoid considering policy priorities from the assessment of individual principles on a case by case basis. Doing so could lead, for example, to 30 different recommendations for more enforcement and more resources for regulatory and enforcement authorities. From a system perspective, the regulatory cost could be heavier than anticipated by individual recommendations. With respect to regulatory resources, the key question should also involve prioritisation by the authorities: the effective allocation of scarce resources to maximise regulatory impact.

References

OECD (2023), *G20/OECD Principles of Corporate Governance 2023*, OECD Publishing, Paris, https://doi.org/10.1787/ed750b30-en. [1]

OECD (2023), *OECD Corporate Governance Factbook 2023*, OECD Publishing, Paris, https://doi.org/10.1787/6d912314-en. [2]

B. The corporate governance landscape

Part B outlines the type of information that a reviewer will need both to form an assessment about the importance of individual principles for the corporate governance framework in a jurisdiction, and to identify questions relevant for a judgement about the essential criteria. A requirement of the Methodology is that a reviewer has a good understanding of the corporate landscape which provides the necessary market and institutional information for both comprehensive reviews and more focused reviews against the Principles. The information collected under Part B can be used by the reviewer to conduct the assessment under Part C under relevant principles. Rather than relying solely on anecdotal evidence to form a general judgement about a jurisdiction, a reviewer might be able to underpin a judgement through the judicious use of statistical indicators. The availability of such statistics varies widely across jurisdictions, and comprehensive data should not be considered as a necessary pre-condition to carry out an assessment. Lack of data for some of the indicators specified in this section should not necessarily negatively influence the reviewer's assessment, although the absence of such data in some cases may be relevant, for example with respect to an assessment of Chapter IV's recommendations on disclosure.

Overview of the economy and capital markets

The first step to understand the capital markets of a jurisdiction is to look at key economic indicators and compare them with those of peer jurisdictions.[1] It is also important to assess the size of the stock and corporate bond markets and the use of market-based financing. An analysis of past corporate failures can also be included to allow the reviewer to understand the historical factors and experiences that have shaped the current corporate governance system and that may still play an important role.

The assessor should review quantitative data on:

(i) trends in real gross domestic product (GDP) growth and per capita GDP
(ii) trends in inflation and unemployment
(iii) total market capitalisation as a percentage of GDP (including all companies listed on different markets in the jurisdiction)
(iv) total outstanding amount of corporate bonds as a share of GDP
(v) the use of market-based financing vs. bank financing in the jurisdiction.

Capital market functioning and market structure

Well-designed corporate governance frameworks will enable capital markets to function properly, and, therefore, an assessment of the functioning of capital markets will reflect on the corporate governance framework in place.

The reviewer may want to start by identifying the main stock exchange(s) and trading facilities. An understanding of the history of the jurisdiction's market structure can contribute to explaining the evolution of capital markets and their development. Therefore, a reviewer should collect information on the available

stock exchange(s) and trading facilities to list and trade, and their initial and current requirements for listing securities.

The reviewer should also collect information on public equity markets dedicated to growth companies, such as Multilateral Trading Facilities (MTFs) in Europe and Alternative Trading Systems (ATS) in North America, and some other growth segments which allow flexible offering methods. This would support an understanding of their structure, requirements, and reporting obligations, as well as the companies traded on these segments. This information is key to understand the use of proportional requirements in segments targeted to growth companies.

When analysing the information and data collected, the reviewer should clearly distinguish between the information concerning regulated markets and that concerning alternative market segments, if any.

The reviewer should seek to collect the following information:

(i) number of publicly listed companies (equity) on the regulated market segment(s) of the stock exchange(s), their market capitalisation, their size and industry composition

(ii) number of publicly listed companies on the alternative market segment(s) (when established), their market capitalisation, their size and industry composition

(iii) number of corporate bonds listed on the regulated market segment(s) of the stock exchange(s) and outstanding amounts

(iv) number of corporate bonds listed on the alternative market segment(s) (when established) and outstanding amounts

(v) trends in initial public offerings (IPOs) and de-listings on the regulated market(s) of the stock exchange(s) and on the alternative market segment(s)

(vi) trends in secondary public offerings (SPOs) on the regulated market(s) of the stock exchange(s) and on the alternative market segment(s).

Stock exchanges or other sources of data may provide the above-mentioned information. Trends would be assessed over the past five to ten years and, to the extent possible, be compared with peer jurisdictions.

Trends in IPOs and de-listings and changes across listing segments (if applicable) may help the reviewer in evaluating whether the market structure of the stock exchange(s) and/or trading facilities is sufficiently clear and, from a regulatory perspective, whether companies have incentives to go public. A review of listing-related trends may also help to discern if companies initially listed in an alternative segment have the incentive to transfer to the regulated market. Importantly, that information will also help to understand if companies are improving their corporate governance over time (assuming that higher listing segments establish stricter corporate governance standards).

Specific initiatives at the jurisdiction level aiming to develop and support capital markets should also be included in the evaluation. Their effectiveness may be analysed based on empirical data and results achieved since their implementation, with data and results collected from all relevant authorities involved in such initiatives as well as publicly available information and the feedback of market participants and stakeholders.

Secondary market liquidity

After evaluating the functioning of primary markets, the reviewer should aim to understand the functioning of secondary markets.

The assessor should review quantitative data on:

(i) trends in the volume of stocks traded (e.g. total dollar amount traded, turnover ratio)

(ii) an estimation of the free-float at the company level

(iii) the frequency of trading and whether trading is concentrated among a few or many companies (e.g. % of total trading volume accounted for by top 5 or top 10 companies)

(iv) other relevant indicators that may depend on each jurisdiction

(v) importantly, these data should be analysed over the past five to ten years to understand the trends and development in capital markets.

It is often useful for the assessment of both the operation of capital markets and the use of control arrangements to know the proportion of shares that could be traded on the market. Many jurisdictions have restrictions on the minimum level of a free float for both an IPO and to remain listed on a stock exchange or one of its specific listing segments. The most general definition is that the free float factor is the percentage of shares remaining after the block ownership and restricted shares adjustments have been applied to the total number of shares. Information on how free float can be measured is provided in Box 1.

Box 1. Measuring the free float

Free float can be calculated as:

Free float factor (%) = 100% – [Maximum (block ownership (%); restricted shares adjustment (%)]

The free float market capitalisation is the portion of a stock's total market capitalisation that is available for trading:

Free float market capitalisation = free float factor ● full market capitalisation

The adjustment for block ownership of shares is applied if blocks of at least 5% of a company's total stock are held in:

- cross-ownership: stock owned either by the company itself, in the form of treasury shares, or owned by other companies
- government ownership: stock owned by either governments or their agencies
- private ownership: blocks of shares owned by either individuals or families and therefore not likely to be available for trading.

This block ownership adjustment is not applied if:

- The blocks comprise less than 5% of the total stock as these might be small enough to be tradeable.
- The blocks are held by — but not limited to — custodian nominees, trustee companies, mutual funds and pension fund holdings, investment companies with short-term investment strategies and pension funds.

In addition, the total number of shares is also adjusted by the restricted shares, i.e. either those that cannot be traded during a certain period or those that have a foreign ownership restriction. Either the block ownership adjustment or the restricted shares adjustment is applied, whichever produces the higher result.

Alternatively, a simpler approach may be utilised:

Floating = Average voting block held by the market (100 - Call) (simple average and weighted average)

where:

Call = Average of the sum of the voting blocks held by all major shareholders (simple average and weighted average)[1]

Considering that it is difficult to obtain information about restricted shares, this is a good proxy of a free float. For each company the free float is 100- sum of “relevant” voting blocks where a “relevant” voting block is one exceeding 5% of voting capital. If it is possible, a “relevant” voting block should not include those exceeding 5% but held by custodian nominees, trustee companies, mutual funds and pension fund holdings, investment companies with short-term investment strategies and pension funds, since they are considered not stable and therefore tradable.

Note: 1. Weighted averages are calculated by “weighting” direct stakes and voting blocks with the market value of the ordinary share capital for each company.

The structure of ownership and control

The structure of ownership and control in each market is key to understand the agency issues at play. Policy makers and regulators are expected to have the structure of ownership and control in mind when designing corporate governance frameworks. To fully understand the structure of ownership and the control of publicly traded companies, three specific aspects need to be considered: (i) the structure of ownership and its concentration; (ii) the instruments of control; and (iii) the exercise of control.

Structure of ownership and its concentration

The reviewer should start by identifying the owners of publicly traded shares and bonds. The distribution of ownership among different categories of owners provides useful information about the corporate governance landscape of a jurisdiction. The owners of direct stakes and voting blocks of stocks should be classified according to a standard categorisation of investor categories.

A categorisation often used by the OECD for comparative data distinguishes between:

- private corporations (listed and unlisted private companies, their subsidiaries, joint ventures); strategic individuals and families (physical persons that are either controlling owners or members of a controlling family or block-holders); public sector (direct ownership by central/local governments, public pension funds, state-owned enterprises and sovereign wealth funds); institutional investors (pension funds, insurance companies, mutual and hedge funds); and other free float, including retail investors (shares in the hands of investors that are not required to disclose their holdings) (De La Cruz, Medina and Tang, 2019[1]). It is also important to distinguish between domestic and foreign investors where possible.

An alternative categorisation is the following:

- domestic investors; families/individuals; non-financial companies; financial intermediaries of which: banks, insurance, collective investment companies (including mutual funds, pension funds and other collective financial investment companies); public sector (including government, local authorities and others public sector bodies); foundations; and foreign investors (aggregate value or same distribution adopted for domestic investors).

These data should prompt the reviewer to determine whether one or more categories are predominant (especially when this is the case for the public sector) and whether some categories are not developed or widespread, including in comparison with peer jurisdictions. For example, if the presence of institutional investors is rather low, the assessor may wish to investigate further what the reasons may be. Another important indicator is the percentage of public sector holdings.

The reviewer should continue by assessing the degree of ownership concentration. The latter provides a measure of the distribution of power between major shareholders and dispersed shareholders, and

provides indications of whether some shareholders can influence company management and whether control is contestable. Concentration of ownership can be computed with reference both to direct stakes and to voting blocks. A useful measure of ownership concentration is the percentage of publicly traded companies in which the three largest shareholders hold more than 50% of the equity base (De La Cruz, Medina and Tang, 2019[1]). The reviewer should examine quantitative data produced by relevant authorities on:

(i) the share of stock market capitalisation and outstanding corporate bonds owned by different categories of investors

(ii) average free float of listed companies

(iii) number of majority owned state-owned publicly traded companies

(iv) a measure of concentration (e.g. the percentage of publicly traded companies in which the three largest shareholders hold more than 50% of the equity base, the average holdings of the largest three shareholders).

An overall picture will need to be drawn from a number of sources, including qualitative assessments by the relevant authorities, investors, academics, etc. and a review undertaken of the legal framework to understand whether there are any restrictions or incentives, for example impacting on foreign ownership or on retail vs. institutional ownership. The statistical base is, however, not always sound and this would have to be taken into consideration by the reviewer (e.g. taking into account whether the data are drawn from company corporate governance statements or from dated declarations to the authorities such as the securities regulator or a company registrar). Often, the ownership records do not reflect the beneficial owner and therefore statistical indicators of concentration and the identity of the owners might be distorted. The reviewer could also consult country indicators of the structure of ownership and ownership concentration reported in the OECD Corporate Governance Factbook which is updated every two years (OECD, 2023[2]).

Instruments of control

Instruments of control over companies used by shareholders include block shareholdings formed either alone or through shareholder agreements. With respect to statistical indicators, thresholds would have to be examined for their relevance to corporate control in the jurisdiction, reflecting the wide-ranging possibilities for control that are often available, both *de jure* and *de facto* (e.g. key patents and brands effectively transferring control outside the company). Controlling blocks may also be formed through instruments such as multiple voting shares, caps on voting rights and by shares with special powers such as the ability to appoint the board. The use of shares with different voting rights should not be perceived as intrinsically negative by the reviewer, who should monitor whether multiple voting rights are allowed, what their incidence is across publicly traded companies, and whether they appear to have been used abusively (which may be assessed more specifically in relation to Chapter 1, Principle I.B. containing recommendations dealing with the effectiveness of the enforcement framework and Chapter II dealing with the rights and equitable treatment of shareholders). For a number of jurisdictions, information about the overall use of such instruments is available from different sources including rating agencies, and in some cases the extent to which cash flow rights and voting rights differ might also be available. Where not available at least in a general form, there is a *prima facie* case that disclosure aspects of the Principles might not be implemented.

Another widespread instrument of control concerns company groups (which is also analysed under Principle I.H.) and especially those that are organised in a pyramid where the difference between voting and cash flow rights can be particularly acute. A reviewer should understand whether publicly traded companies within company groups are a common feature of the market and whether they are generally domestic company groups or groups operating across borders. Cross-border operations of publicly traded

companies within company groups increase the importance of having in place cross-border enforcement co-operation agreements as called for in Principle I.G.

Indicators that a reviewer should look for include:

(i) incidence of block and controlling shareholdings, the ratio between cash flow and voting rights, types of control mechanisms such as shareholder agreements

(ii) the share of listed companies with different classes of shares, voting and ownership ceilings, etc.

(iii) indicators of company groups and the potential problems associated with them: ratio of cash flow rights to control rights, average number of layers in company pyramids.

It is important that cross holdings of companies in the group, including the existence of private companies, are also taken into account in order to know the type of principle/agent incentive structure the corporate governance framework will have to address.

Exercise of control

With respect to the exercise of control, several indicators such as the number of companies controlled through shares with special rights and staggered boards could be used by the reviewer. Rating agencies and analysts have also found it informative to examine the percentage of the free float (i.e. excluding controlling shareholders) that participates in the general meeting of shareholders and they have also constructed indicators of shareholder rights. These should be used with care. The incidence of voting/participation is often regularly monitored by stock exchanges and regulators so that a great deal of aggregate information could be available which might be indicative of how the corporate governance system is functioning. Other indicators point more to the consequences of corporate governance arrangements but, although widely used, they rely on a number of critical assumptions so should be used judiciously. For example:

(i) The use of different types of board structures, incidence of board members not appointed at the general meeting of shareholders (i.e. based on staggered terms).

(ii) The percentage of average free float participating in general shareholder meetings.

The legal and regulatory framework

As part of the institutional information considered for the corporate governance landscape, it is also important to present a general overview of the legal framework that goes beyond the civil law/common law distinction.

The legal framework is generally comprised of company law or commercial code and securities law, procedural laws and, in some cases, relevant provisions may also be included in the civil code. Important principles for economic activity may be included in the constitution. Other pieces of legislation which should be collected for the assessment may include audit and accounting laws, internationally recognised standards consistent with a jurisdiction’s laws and regulations, and non-financial disclosure requirements (e.g., related to information on sustainability); bankruptcy and insolvency legislation; takeover laws; etc.

Regulations issued by the authority in charge of capital market supervision and the listing rules of the stock exchange(s) are also relevant. This list does not aim to be comprehensive as other pieces of law/regulation may also be analysed by the assessor based on the specificities of the framework being reviewed, including more technical laws/regulations when conducting a more focused thematic review. A better understanding of the legal and regulatory framework will allow a reviewer to assess whether there are any gaps in the framework, lack of clarity and/or overlap between different pieces of law/regulation.

The preamble of Chapter I of the Principles underlines that legislative and regulatory elements of the corporate governance framework can be complemented by soft law elements such as corporate governance codes or equivalent instruments. This section of the assessment should therefore also include information about codes and principles and other complementary mechanisms and their evolution in the jurisdiction. When there is no soft law mechanism or alternative mechanism in the jurisdiction, an assessor should evaluate whether the corporate governance framework is adequately addressed in other instruments.

It is important to underpin an understanding of the institutional setting and context with background information. For example, an awareness of the following elements is also relevant: how soft law mechanisms have developed in the jurisdiction, how often they are revised and according to what procedures, the types of compliance mechanisms, the companies that are subject to soft law mechanisms reporting, and the authority responsible for reviewing companies' reporting. Importantly, the degree of compliance by companies represents a core element of the corporate governance landscape as it allows to understand the efficacy of soft law elements as a complement to legal and regulatory requirements and voluntary practices adopted by companies. The criteria to assess compliance with soft law mechanisms are provided under Principle I.B. in Part C.

The institutional framework for corporate governance

An overview of the institutional framework allows the reviewer to identify the authorities, ministries, and other agencies with responsibilities for corporate governance. These authorities typically include the supervisory, regulatory and enforcement authority in charge of capital markets and corporate governance, and ministries responsible for capital markets, audit supervision (the ministry of finance or equivalent) and those that have under their purview the legislation for corporate governance and other judiciary matters (typically the ministry of justice or equivalent). Stock exchanges and other self-regulatory organisations as well as company/court or trade registries that provide corporate information are also part of the institutional framework. Moreover, an advanced and effective market infrastructure that supports the functioning of the public equity market is of critical importance for the issuance, trading, clearing and settlement of securities. The organisation of the judiciary and a solid understanding of which courts are competent for commercial/corporate governance disputes are also an important element.

The review should consider a list of relevant authorities, ministries, institutions and bodies, together with the law/regulation establishing them (where relevant) and their main governance characteristics. Their key functions and contribution to corporate governance should also be identified together with the extent of their supervisory and enforcement roles. For example, the assessor should ascertain whether the stock exchange(s) has/have the authority to enforce its/their rules and whether they impose market protection measures in practice. Second, a reviewer should identify the public authority/authorities in charge of the supervision of capital markets and corporate governance, understand its/their statutory objectives, and the extent of its/their relations and interactions with other relevant authorities and ministries. Third, the reviewer should understand the role of the different ministries with responsibilities for corporate governance and its enforcement, and for developing and monitoring laws in this area. To understand the judiciary's efficiency and functioning, the reviewer should first develop a solid understanding of how the judiciary is organised and whether there are specialised courts/sections of courts competent to adjudicate commercial/corporate governance disputes.

The institutional framework should also rely on a solid market infrastructure. The reviewer should therefore also identify the body carrying out the issuance, trading, clearing and settlement of securities. The processes used as well as recent technical improvements and other initiatives can provide valuable information. Importantly, the reviewer should also understand the stock exchange(s)' ownership structure and how it may have evolved since its establishment. Concerning the rules and conditions for stock and

bond market listings on the regulated market(s), the assessor's analysis should address whether these are clearly defined and coherent, including in light of the statistics collected as part of the capital market section of this Methodology.

References

De La Cruz, Medina and Tang (2019), "Owners of the World's Listed Companies", *OECD Capital Market Series*, https://www.oecd.org/corporate/Owners-of-the-WorldsListed-Companies.htm. [1]

OECD (2023), *OECD Corporate Governance Factbook 2023*, OECD Publishing, Paris, https://doi.org/10.1787/6d912314-en. [2]

Notes

[1] Peer jurisdictions can include comparisons to other jurisdictions in the same region, OECD averages, or similar sized markets.

C. Chapters of the Principles

Chapter I. Ensuring the basis for an effective corporate governance framework

Introduction

The overarching principle states that "The corporate governance framework should promote transparent and fair markets, and the efficient allocation of resources. It should be consistent with the rule of law and support effective supervision and enforcement." The Principles recommend that jurisdictions seeking to implement the Principles should "monitor their corporate governance framework, with the objective of maintaining and strengthening its contribution to market integrity, access to capital markets, economic performance, and transparent and well-functioning markets. As part of this, it is important to consider the interactions and complementarity between different elements of the corporate governance framework and its overall ability to promote ethical, responsible and transparent corporate governance practices."

Principles I.A. to I.H. of Chapter I provide the basis for an effective corporate governance framework and should therefore be studied carefully for any assessment against the Principles, for both comprehensive and focused thematic reviews. For this reason, cross-references of relevant principles for the assessment of Principles I.A. to I.H. are not provided, given that these principles are intended to be essential elements to understand the rest of the principles and recommendations in Chapters II to VI. The information collected per Part B of this Methodology aims to provide useful background information to build on for developing an assessment against Principles I.A. to I.H.

Issues and assessment criteria

Principle I.A.: The corporate governance framework should be developed with a view to its impact on corporate access to finance, overall economic performance and financial stability, the sustainability and resilience of corporations, market integrity, and the incentives it creates for market participants and the promotion of transparent and well functioning markets.

Principle I.A. advocates that corporate governance should be developed with the objective of encouraging market-based financing and supporting companies' contribution to overall economic performance, including in overcoming temporary downturns. The authorities should also consider both the costs and benefits of current and proposed legal and regulatory measures, by allowing for proportionality and flexibility for publicly traded companies, in particular with respect to their size.

Likely practices to be examined

The reviewer should consider Principle I.A.'s recommendations as an overarching principle that aims to determine whether corporate governance is functional for companies' access to finance and its contribution to overall economic performance. Principle I.A. cites a wide range of considerations that the corporate

governance framework should take into account, raising challenges for a comprehensive assessment. Therefore, to make the task manageable for a reviewer, two main aspects of Principle I.A. can be reviewed independently to form a judgement of the main components that this recommendation entails: (i) the operation of equity markets, including market integrity, its transparency and efficiency; and (ii) the proportionality and flexibility of the corporate governance framework.

The first aspect concerns the need to form a judgement about the operation of the equity markets including their transparency and efficiency, building on the information collected under Part B. A reviewer should also assess the operation of the stock exchange(s), market infrastructure and surveillance, etc. Above all, the question is the type of incentive structure they might help create. To form an assessment, the reviewer will need to carefully review the data collected as per the guidance contained in Part B. For example, the trends in the number of publicly traded companies and the number of IPOs and de-listings will reveal whether companies tend to list or de-list from the market or if companies prefer to remain private. Similarly, a solid understanding of the stock exchange(s)' listing structure and costs involved with listing and other operations may inform this assessment. Jurisdictions in which traditional bank financing is overly dominant vis-a-vis market-based financing may signal that this option may be considered by companies and market participants as costly, or not sufficiently developed, liquid or competitive.

Consultation with market participants, investors and the authorities will be essential to assess this Principle, paying particular attention to whether they regard the capital market as a viable opportunity for financing and growth or consider it particularly costly, risky or opaque and therefore inefficient. It is important to seek out diverse views from a cross section of market participants (e.g., large vs. small, active vs. passive, domestic vs. foreign, proxy advisors and analysts). In jurisdictions with less developed capital markets, the range of market participants may be more limited. Therefore it is left to the assessor to determine the minimum number of respondents to be interviewed or surveyed, depending on the context, but bearing in mind the objective to seek out a diverse range of informed market participant views. While perceptions of the market's risks and transparency will also be relevant for an assessment of overall market integrity, such an assessment should draw further upon other Principles in this chapter and in particular Principles I.B. and I.E. When access to a jurisdiction's market is considered as overly costly, or its transparency and integrity are perceived as weak, there is a *prima facie* case that Principle I.A. is either not or only partly implemented.

The second aspect to be considered relates to the proportionality and flexibility of the corporate governance framework. The reviewer can analyse the information collected under Part B, particularly in relation to capital markets and the legal and regulatory framework, to determine the extent to which corporate governance supports well-functioning markets. The annotations to Principle I.A. suggest that factors that may call for flexibility include the company's size, ownership and control structure, geographical presence, sectors of activity, and stage of development. It is important to consider whether the structure for listing developed by the stock exchange(s) incentivises or at least does not discourage companies to list and whether corporate governance requirements are framed in accordance with principles of proportionality and flexibility. Such principles may imply that based on size or other criteria, different corporate governance requirements are applicable, with a view to support the functioning of markets and provide incentives for capital markets development. The reviewer should also assess whether flexibility and proportionality are implemented as transitory or permanent measures and their impact on companies' incentives to continue adhering to the highest corporate governance standards.

An assessment of Principle I.A. should also consider the views of the corporate sector on the flexibility of the corporate governance framework (i.e. is it regarded as too "one size fits all" and as not addressing the specific needs of businesses) and the views of market participants on whether the corporate governance framework is burdensome and therefore hindering market-based financing. At the same time, an assessment of the application of proportionality and flexibility must also take into account investor views on whether the framework still provides for sufficient market transparency and enforceability of shareholder rights to support investor confidence in the integrity of the market (e.g. as called for under Principle I.B.).

In reaching an overall assessment, it is important to recognise that even with appropriate and transparent market structures, incentives and corporate governance frameworks that give due regard to proportionality and flexibility, a jurisdiction may still fall short of ensuring access to equity market finance in practice. In this regard, a reviewer should also recognise extenuating circumstances that may present special challenges, such as a jurisdiction's size, economic circumstances or unexpected events. As this Principle is focused primarily on the role that the corporate governance framework plays in supporting market access to finance, the Principle could still be assessed as broadly or fully implemented if the policy measures in place are considered to appropriately promote and incentivise transparent and well-functioning markets. It therefore will be important to note in the overall assessment whether constraints on the development of the market can be addressed through policy, regulatory or institutional reforms or are structural in nature.

Principle I.A. highlights the importance of ensuring efficient access to finance as an element that will also support a company's sustainability and resilience. When an assessment finds that a market is deemed not sufficiently liquid and developed, companies may not have access to the resources needed. A more specific evaluation of how the corporate governance framework may support achievement of objectives related to sustainability and resilience can be undertaken with respect to Chapter VI of the Principles.

Essential criteria

1) Is the operation of the capital market viewed by publicly traded companies and investors as functioning efficiently and transparently in a way that incentivises corporate access to finance?
2) Do investors see overall market transparency (company disclosures, the way in which they are made and relevant regulations) as the foundation for an acceptable level of market integrity associated with low jurisdictional risk?
3) Are corporate governance provisions imposed based on size and other criteria in accordance with the principles of proportionality and flexibility to incentivise good corporate governance practices?
4) Do publicly traded companies perceive the corporate governance framework as flexible enough? Or is the regulatory framework burdensome for issuers to the point that it discourages companies to use market-based financing?

Principle I.B.: The legal and regulatory requirements that affect corporate governance practices should be consistent with the rule of law, transparent and enforceable. Corporate governance codes may offer a complementary mechanism to support the development and evolution of companies' best practices, provided that their status is duly defined.

Likely practices to be examined

A reviewer should consider the quality of laws and regulations, their transparency, and in particular whether they are enforceable and enforced in practice. In many jurisdictions, laws and regulations might be loosely formulated and not enforceable, or even well understood. Sometimes procedural rules such as discovery powers, pleading rules and rules governing the allocation of legal costs might render enforcement difficult, if not impossible. The reviewer should note the incidence of significant laws and regulations which have never, or only occasionally, been tested in the courts as well as the occurrence of temporary decrees. This is particularly important in the areas of board member and auditor liability, including the duties of board members and controlling shareholders vis-à-vis the company and shareholders or also in areas pertaining to the institutional framework for corporate governance, such as temporary laws or decrees which may impair their independence and autonomy of supervisory, regulatory and enforcement authorities. In some cases, laws and regulations associated with individual principles are necessarily general or incomplete. In these cases, the reviewer should investigate whether provision has been made for courts, regulators, etc., to interpret and complete them effectively. Where important areas of law and regulation discussed above

are on the books but only seldom if at all enforced, the jurisdiction should be noted as partly implementing the Principle and the primary causes noted.

A key issue in some cases concerns the rule of law. In the corporate governance context (i.e. excluding civil rights issues) it will be important for the reviewer to note whether there is a general and marked distrust of the judiciary and the authorities. Issues arise when laws and regulations are enforced in an inconsistent manner with poor predictability or without sufficient technical understanding, which ultimately affects both domestic and foreign businesses, their economic performance and trust in the investment climate. A lack of consistency and transparency in the exercise of discretion granted to courts and the authorities in enforcing and interpreting the regulatory system undermines confidence and trust in the rule of law and, therefore, the development of a rule-based system. Arbitrary actions or questionable use of law and regulation not subject to independent review involving corporate issues such as confiscation of property or repudiation of contracts and agreements should, for example, lead a reviewer to conclude that the system is not compatible with the rule of law. Understanding how and the extent to which corporate disputes are adjudicated by the courts and other institutions by requesting data from the judiciary as well as from other authorities responsible for enforcement for securities markets is also an important indicator of the effectiveness of enforcement practices. While lack of transparency and enforcement do not constitute grounds in themselves for assessing this one aspect of the Principle as not fully implemented, this assessment should carry a heavy weight in the overall assessment of the Principle.

The decision-making process for corporate governance laws, regulations and other instruments as well as soft law mechanisms such as corporate governance codes should provide a relevant and observable guide in many cases. To this end, the process and manner in which public consultations are carried out should be taken into account for the assessment. To be effective, such a process needs to be given an adequate consultation period and it is considered good practice for the authorities to make all comments publicly available and to justify why some have or have not been taken into account in the final decision. In making such decisions, there should be an indication that there is a consideration of likely costs and benefits of the proposed changes including with reference to the transparency and enforceability of such provisions, as well as their efficacy in dealing with the relevant corporate governance weaknesses. While corporate governance objectives formulated in voluntary codes and standards do not have the status of law or regulation, they can play an important role in improving corporate governance arrangements. Their status should be duly defined, implying that the scope and conditions for their application, as well as how implementation is monitored, should be clear for authorities and market participants. Many codes and standards of corporate governance are on a “comply or explain” basis but they vary as to whether this is also a regulatory requirement and also whether corporate governance reports are monitored by the regulatory authority or left exclusively to market participants. Principle I.B. should be analysed in conjunction with sub-Principle IV.A.9. which aims to assess disclosure about compliance with voluntary codes and standards. The reviewer will need to be familiar with the specific requirements of the code and their status, and have a good understanding of how widely it is applied. In examining the individual principles, the status and operation of the codes/voluntary standards should be kept in mind by the reviewer since they may vary according to the principle involved.

Essential criteria

1) Are the legal and regulatory requirements that affect corporate governance practices and outcomes (a) generally well understood by market participants; (b) reasonably foreseeable and not subject to important temporary decrees and back-dated amendments; and (c) sufficiently enforced in an efficient, consistent and even-handed manner so as to constitute a transparent system?
2) Do courts and authorities enforce corporate governance rules in a consistent manner?
3) Do the authorities and the legislator develop policies, laws and regulations and soft law mechanisms for the corporate governance framework on the basis of effective and timely

consultation with the public (corporations and shareholders including their representative organisations, and stakeholders)?

4) When corporate governance codes and principles are used as a standard or as a complement to legal or regulatory provisions, is their status in terms of coverage, implementation, compliance and possible sanctions (i.e. market or regulatory) clearly specified?

Principle I.C.: The division of responsibilities among different authorities and self-regulatory bodies should be clearly articulated and designed to serve the public interest.

Likely practices to be examined

Effective enforcement requires that the allocation of responsibilities for supervision, implementation and enforcement among different authorities is clearly defined so that the competencies of complementary bodies and agencies are respected and used most effectively. For example, the securities market regulator may share powers with other sectoral regulators (for instance, banking and insurance supervisors, and company registrar/company regulator) resulting in either over-regulation or ineffective enforcement/oversight such as where information cannot be exchanged between institutions. In some cases, the division of responsibilities may create gaps although the reviewer would also have to examine whether incentives, disciplinary forces or standards are already effective in dealing with the situation.

Overlapping and perhaps contradictory regulations between different authorities is also an issue that should be monitored as well as any significant inconsistencies between legal domains that hamper enforcement. An issue of particular concern to a reviewer is the applicability of corporate governance codes for companies. Some codes apply to companies listed or publicly traded in a jurisdiction while others only apply to companies incorporated in a jurisdiction so that a listed company might not be covered by any code.

Potentially conflicting objectives, for example where the same institution is charged with attracting business and sanctioning violations, should be avoided or managed through clear governance provisions. Assessors should look for evidence of conflicting objectives, such as where the institution in question is so focused on encouraging listings that it has a weak enforcement record enabling weakly governed companies to trade on the market, which conflicts with an objective of promoting market integrity.

When regulatory responsibilities or oversight are delegated to non-public bodies, notably stock exchanges, or other professional organisations and private entities such as a central depositary, it is useful to explicitly assess why, and under what circumstances, such delegation is desirable. In addition, the public authority should maintain effective safeguards to ensure that the delegated authority is applied fairly, consistently, and in accordance with the law. It is also essential that the governance structure of any such delegated institution be transparent and encompass the public interest, including appropriate safeguards to address potential conflicts of interest. The role of stock markets is covered implicitly by a number of principles but the reviewer will nevertheless need to consider it explicitly in Principle I.D.'s review.

Essential criteria

1) Is there a clear division of responsibilities between different authorities in a jurisdiction, not hampered by conflicting objectives, in the legal framework as well as in practice?
2) Is there an effective system of co-operation between them in place?
3) Are there significant inconsistencies in terms of overlaps or gaps between key laws and regulations?
4) Do non-public bodies, i.e. stock exchanges or other organisations, with delegated responsibilities for parts of the corporate governance framework carry out their functions in an effective and transparent manner which encompasses the public interest?

Principle I.D.: Stock market regulation should support effective corporate governance.

Likely practices to be examined

The annotations to Principle I.D. state that "stock markets can play a meaningful role in enhancing corporate governance by establishing and enforcing requirements that promote effective corporate governance by their listed issuers." Stock exchanges' listing rules often contain corporate governance related requirements for listing and for governing trading on their facilities. In this regard, "policy makers and regulators should assess the proper role of stock exchanges and trading venues in terms of standard setting, supervision and enforcement of corporate governance rules." Where this is the case, and the enforcement of such rules is also within the remit of the stock exchanges, assessors may wish to review the quality and frequency of enforcement of these rules, bearing in mind that profit-maximising stock markets may not always be incentivised to vigorously enforce corporate governance rules. In this context, assessors may also wish to refer to the Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation, notably Principle 9 relating to self-regulatory organisations (IOSCO, 2017[1]). A more general issue to consider is whether the exchanges' rules themselves support effective corporate governance and capital markets development, or whether they are primarily designed to encourage trading operations without sufficient attention to the need for effective corporate governance or incentives for listing.

Stock exchanges' rules often further differ by stock market segment as well as between regulated and alternative markets. When they differ, based on the information collected and analysed under Part B of this Methodology, an important element to determine implementation of Principle I.D. consists in reviewing and analysing whether rules for listing and trading on each segment support strong governance frameworks. For example, a reviewer can check whether the listing structure is not overly complex and whether different requirements are coherent with the overall development of the jurisdiction's capital markets, legal and regulatory framework, and predominant corporate governance practices. One relevant indicator is the extent to which companies are willing to adhere to stricter corporate governance rules and requirements for being listed in the top-tier segment(s) of the stock exchange. While the incentives of companies to list on such markets also depends on the degree to which investors reward adherence to such standards, stock exchanges and supervisory authorities who may play a role in approving their listing may be able to influence adherence based on a consideration of an appropriate balance between the costs and benefits of compliance with such standards.

When there are different market segments and/or a regulated and an alternative market segment, the reviewer can analyse whether stock exchanges' rules are developed in a coherent manner. For example, an indicator is whether there are incremental and proportional corporate governance rules depending on companies' size, free float or other criteria. Many elements, including an analysis of the number of companies listed and traded on the different segments, may suggest to a reviewer whether rules are balanced, not overly burdensome and support strong governance frameworks for companies. Another indicator is whether there are periodic evaluations in place and incentives or mechanisms for companies to move to different listing segments, either because they satisfy conditions for moving to a segment with more stringent requirements or because they failed to comply with some of the requirements of their segment. Similar indicators and mechanisms may also be relevant for companies traded on alternative market segments (when applicable), to verify whether stock exchange(s) have in place a procedure to encourage publicly traded companies to get listed on the regulated market.

Essential criteria

1) Are stock exchanges that have been delegated responsibilities for parts of the corporate governance framework effective and transparent and does their structure encompass the public interest?

2) Do stock exchanges' rules for listing and for governing trading foster access to finance and strong governance frameworks?

Principle I.E.: Supervisory, regulatory and enforcement authorities should have the authority, autonomy, integrity, resources and capacity to fulfil their duties in a professional and objective manner. Moreover, their rulings should be timely, transparent and fully explained.

Likely practices to be examined

The annotations to Principle I.E. note that "Supervisory, regulatory and enforcement responsibilities should be vested with bodies that are operationally independent and accountable in the exercise of their functions and responsibilities, have adequate powers, proper resources, and the capacity to perform their functions and exercise their powers, including with respect to corporate governance. Many jurisdictions have addressed the issue of political independence of the securities supervisor through the creation of a formal governing body (a board, council, or commission) whose members are given fixed terms of appointment. Some jurisdictions also stagger appointments and make them independent from the political calendar to further enhance independence. Some jurisdictions have sought to reduce potential conflicts of interest by introducing policies to restrict post-employment movement to industry through mandatory time gaps or cooling-off periods. Such restrictions should take into consideration the regulators' ability to attract senior staff with relevant experience. These bodies should be able to pursue their functions without conflicts of interest and their decisions should be subject to judicial or administrative review. At the same time, supervisory staff should be adequately protected against the costs related to defending their actions and/or omissions made while discharging their duties in good faith."

Further to information collected under Part B of this Methodology in relation to the institutional framework, the reviewer may form an initial understanding on responsible authorities and their mandate(s). Important aspects to be considered are included in the law and/or regulation establishing the authority, for example in relation to its mandate, composition and appointment of the governing board and/or head, and internal structure, as well as the provisions specifying to whom the authority responds and who is responsible for approving its budget, resources and internal rules. Whether there is clear authority may be also partly inferred from the assessment against Principle I.C. However, there are different elements that need to be analysed and balanced to fully evaluate whether competent authorities have sufficient authority, autonomy, integrity, resources and capacity, and whether they are independent from political bodies as well as supervised entities.

Although background information about the supervisory, regulatory and enforcement authorities can be gathered as part of Part B of this Methodology, a judgement should also be influenced by the assessments of the individual principles and by the work of other standard setters and any associated review mechanisms. With respect to the latter, standards relating to the authority and integrity of supervisory and regulatory authorities have been formulated by IOSCO, the Basel Committee on Banking Supervision and by the International Association of Insurance Supervisors, and reviewed in some cases by the IMF and the World Bank, and by some standard setters themselves. In forming a judgement about the individual principles, a reviewer might often note a lack of institutional capacity including inadequate funding and staff resources that might contribute to inadequate or ineffective enforcement and supervision. However, regulatory, supervisory and enforcement resources are always likely to be in short supply, making it important to use those resources effectively. This will usually involve allocating them to where they will have the greatest impact on the regulatory system, for example by applying the principles of risk-based supervision. One question for the reviewer is whether the institutions are in fact permitted to do this, and if so, whether such an economic use of resources is in fact undertaken. The reviewer should also note cases where new laws, regulations, etc., do not take into account at the outset the limited resources available, a

point incompatible with the implementation of Principle I.A. Using limited resources effectively will also require that market forces are used where possible.

Forming an overall opinion about the independence, capacity and reputation of these authorities is not a judgement that a reviewer can make *ex-ante* but only together with extensive consultations of market participants and after observing the actual behaviour the authorities might have in relation to individual principles. With respect to independence, the reviewer should understand how the authority is governed. Most commonly, to foster independence, authorities establish a formal governing body, which can vary in size, composition, terms of appointment and mandate. This body is usually appointed by the political representation of the jurisdiction (e.g. the parliament, government, or a combination of these). Therefore, it is important to carefully study the appointment process and whether there are any safeguards to make these appointment(s) independent from the political calendar, for example through staggered appointments. Some jurisdictions also impose limits on the number of representatives on the governing body who are affiliated with any single political party Measures to minimise conflicts of interest, such as post-employment cooling off periods are other possible important indicators. Rules prohibiting or severely limiting trading activities of members of a formal administrative body involving financial instruments supervised by these authorities is also used to reduce conflicts of interest. The reviewer should consider whether such measures are carefully balanced in terms of their length and remuneration, to make sure the authorities retain the ability to attract senior and competent staff to cover such roles. These measures, when adopted, together with the reputation and information collected from market participants can help understand authorities' level of independence. In relation to integrity, it is necessary to form a judgement about whether the authorities are free of commercial and political interests (i.e. regulatory capture). This may be reflected in the composition of the governing bodies of the institutions and also in their behaviour. It might also be reflected in the funding arrangements for the authorities that leave them vulnerable to special interests. The adoption of an internal code of conduct and *ad hoc* guidance to address conflicts of interest, including how they are adopted, revised and disseminated among staff should also be considered.

These bodies will have a significant demand for fully qualified staff to provide effective oversight and investigative capacity and will therefore require appropriate funding. Understanding the process to set the authorities' budget and the source for their financing helps the reviewer identify whether they have sufficient autonomy and resources to carry out their mandate(s). Autonomy over budget is generally assumed to reinforce independence. Most regulators levy fees and fines from supervised entities. In these cases, there should be transparency and clear indications on the processes for setting and reviewing the level of fees and fines imposed. Another common option is to rely on a mix of public and self-funding. Funding arrangements to help ensure integrity are then often associated with accountability mechanisms. Such arrangements are compatible with full implementation of the Principle. Judicial review is one such accountability mechanism and annual reports on objectives and activities to the legislature another.

An evaluation of the authority's resources has to take into account its staffing. The authorities should have sufficient and competent staff to carry out their functions. When the authority's staff or market participants point out deficiencies in enforcing rules or carrying out other functions within their mandate, there may be signals that budget and/or staff are not sufficiently set or allocated. Furthermore, as noted in the annotations of Principle I.E. "supervisory staff should be adequately protected against the costs related to defending their actions and/or omissions made while discharging their duties in good faith." When the number of disputes involving employees is reported to be high, the efficiency of the regulator may be undermined, and the reviewer should carefully assess whether the liability regime is balanced and does not discourage taking on such roles within the authority. The authorities also have a great responsibility to help underpin Principle I.B. that calls for a transparent and predictable legal and regulatory framework. This should be achieved through a process ensuring that rulings are "timely, transparent and fully explained". The reviewer should check to see that the authorities are releasing to all market participants explanations for their decisions so as to establish transparent rules of the game. Such systems might also include advisory notes to market participants and a wide dissemination of responses to frequently asked

questions. The reviewer will also need to gather the views of market participants about whether the practices amount to clear and consistent rules, the outcome advocated by the Principle.

Essential criteria

1) Do supervisory, regulatory and enforcement authorities have the authority and integrity to be effective and free from commercial and political influence?
2) Do these authorities have sufficient resources to fulfil their objectives and guarantee their integrity and authority?
3) Do authorities have a reputation for being transparent, independent, competent and consistent according to market participants?
4) Do authorities allocate their resources effectively to maximise the impact of regulatory, supervisory and enforcement actions or are there any barriers in the form of either inefficient legislation and regulation which prevent such an allocation?

Principle I.F.: Digital technologies can enhance the supervision and implementation of corporate governance requirements, but supervisory and regulatory authorities should give due attention to the management of associated risks.

Likely practices to be examined

Some technologies have the potential to improve disclosure practices, both from a regulatory standpoint by facilitating enforcement and increasing regulatory efficiency (supervisory technology, or “SupTech”), and from a company perspective by helping companies reduce the costs and burden of their regulatory compliance (regulatory technology, or “RegTech”). SupTech generally refers to digital tools and solutions used by public sector regulators and supervisors to carry out their responsibilities, for example to increase efficiency in these activities, better detect market manipulation instances or, in combination with RegTech, to ease the regulatory burden on supervised entities to report on their compliance. While this recommendation addresses all digital technologies used by market supervisors, particular consideration may be given to recent and emerging uses of technologies. This may apply to more than one institution with responsibilities for the corporate governance of publicly traded companies (for example supervisors of the audit profession, stock exchange, bank regulator, etc.) but, in order for the assessment to be manageable, priority should be given to the supervisory activities of the securities regulator.

The first task for the assessor is to examine whether the jurisdiction’s authorities have adopted digital technologies in corporate governance supervisory and enforcement processes. Building an understanding of what technologies are used, particularly emerging ones, is fundamental to assess how the jurisdiction is using emerging opportunities and risks to assess the implementation of Principle I.F. A reviewer should also bear in mind that jurisdictions may have different approaches in terms of the type of digital technologies adopted and the Principles aim to remain technology neutral. The assessor should not favour one technology over the other in the review, but evaluate whether, when these technologies are used, there are adequate mechanisms in place to assess and manage their benefits and risks and whether there is a strategy or plan to adopt these technologies. The authorities and publicly available information can provide insights as to which digital technologies have been adopted and for what purposes.

The Principles recognise that while technological developments may help improve regulatory and supervisory efficiency and effectiveness, they also entail a number of challenges for regulators. Some aspects to be considered include, for example, whether the authorities have developed and use secure platforms with common definitions, formats and processes, machine-readable electronic formats, and common standards to facilitate data input and integrated analysis. The assessor should review whether there are mechanisms to ensure and/or manage: (i) the quality of data; (ii) interoperability between systems

in the development of reporting formats; (iii) third-party dependencies; (iv) digital security risks and data privacy and protection; or (v) other related aspects.

In addition to the need to ensure data quality and standardisation, SupTech may create additional challenges for authorities. For example, it may be appropriate to assess whether authorities have staff with adequate skills, understanding and competencies with respect to the technology, software and hardware they use, as well as whether possible budget constraints, rigid procurement rules and obsolete regulatory frameworks may hinder an appropriate oversight of SupTech technologies and associated risks. Additional considerations may include whether large legacy projects may create risks related to third part dependencies, and whether mitigation strategies to reduce room for regulatory arbitrage are in place.

An important factor to assess when authorities use artificial and algorithmic decision-making in supervisory processes is whether a human element is maintained in the process to avoid over-reliance on digital technologies, and to safeguard against risks of incorporating human biases in algorithmic models. This is recommended to appropriately manage the risks arising from the use of digital technologies and to foster trust in these processes.

In addition to considering authorities' use of digital technologies, an examination should also assess whether publicly traded companies use digital technologies in regulatory compliance processes. RegTech can potentially improve disclosure by companies, for example by improving accuracy and reducing human error. Supervisory authorities' establishment of common standards and platforms for companies' disclosure of information to the market may facilitate efficient use of technologies for this purpose. However, the challenges are similar to those of SupTech and necessitate adequate oversight and management of risks. They include, among others, the need for skills to supervise the use of such technologies, the interoperability and integration with legacy systems, the cost of implementation, cybersecurity threats, and future regulatory changes.

Essential criteria

1) Are there adequate safeguards in place to manage potential challenges arising from the use of digital technologies?
2) Do relevant authorities ensure that staff have adequate technical competences for carrying out activities to leverage the benefits of deploying emerging digital technologies?
3) What safeguards are in place, if any, to maintain a human element when digital technologies and SupTech tools, in particular artificial intelligence, are used?

Principle I.G.: Cross-border co-operation should be enhanced, including through bilateral and multilateral arrangements for exchange of information.

Likely practices to be examined

The annotations to Principle I.G. note that "International co-operation is becoming increasingly relevant for corporate governance, notably when companies or company groups are active in many jurisdictions through both listed and unlisted entities, and seek multiple stock market listings on exchanges in different jurisdictions."

Assessors may wish to refer to the Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation, notably regarding Principles 13-15 for co-operation in regulation (IOSCO, 2017[1]), and in particular those referring to listed companies and companies that seek a listing of their securities. These include recommendations that the regulator "should have authority to share both public and non-public information with domestic and foreign counterparts"; that regulators "should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts"; and that "the regulatory system should allow for

assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers."

Essential criteria

1) Have IOSCO Principles 13-15 for co-operation in regulation been fully implemented as far as they refer to listed companies and companies that seek a listing of their securities?
2) Does the jurisdiction have information sharing arrangements with other relevant jurisdictions for effective cross-border co-operation on enforcement and/or multilateral arrangements (e.g. IOSCO's Multilateral Memorandum of Understanding Concerning Consultation and Co-operation and the Exchange of Information) that allow exchange of relevant information for securities regulation enforcement actions?

Principle I.H.: Clear regulatory frameworks should ensure the effective oversight of publicly traded companies within company groups.

Principle I.H. recognises that well-managed publicly traded companies within company groups can have benefits but also highlights that they can, in some cases, create risks for shareholders and stakeholders.

Likely practices to be examined

A review against Principle I.H. requires an understanding of the specific features of publicly traded companies within company groups in the jurisdiction, for example by gathering information on the number of publicly traded companies that are either a controlling or controlled (e.g. subsidiary) part of a group structure in the jurisdiction (or another more approximate indication of the use of group structures by listed companies); and clarifying whether subsidiaries are listed in different jurisdictions. Identifying in which sectors they may be most common is also relevant for an understanding of the coherence of regulatory requirements for such groups, notably in relation to listed financial conglomerates that may be subject to multiple supervisory authorities. The prevalence of publicly traded companies within company groups in some jurisdictions and their complex structure therefore calls for effective regulatory oversight. Oversight of these group structures should be evaluated in conjunction with Principle I.G.

Once the background information is collected, it should be determined whether a definition of a group of publicly traded companies has been established and whether criteria for the oversight of publicly traded companies within company groups have been set. The definition could be set in law or regulation (e.g. company or securities laws, listing rules, regulation of financial institutions, other laws, accounting standards), either explicitly or implicitly through references to the main components such as a parent company or a set of subsidiaries, or with respect to a company exerting effective control of other companies through direct or indirect ownership stakes. A definition is often established in multiple sources as the implications of publicly traded companies within company groups span different domains of law. Publicly traded companies within company groups may also be addressed in the national corporate governance code or equivalent instrument. The assessor should therefore review whether there are recommendations relevant to group activities, such as for the use of self-regulatory guidelines or protocols and for the prevention/management of potential conflicts.

The oversight criteria for publicly traded companies within company groups could cover aspects such as the controlling relationship of group companies and their parent, companies' domicile, and appropriateness of inclusion in consolidated financial reporting, among others. An assessment of the effective oversight of groups should also evaluate transparency requirements for company group structures and intra-group activities, which should be evaluated in conjunction with sub-Principle IV.A.3. on capital and group structures and their control arrangements. Disclosure requirements could include, among others, disclosure of ownership structures, relationships among key shareholders, governance policies, and

disclosures related to subsidiaries. For example, the reviewer may benefit from information on a group's structure, membership of the company group, ownership relationships, jurisdiction of incorporation, and/or substantial characteristics of group relations.

Furthermore, the framework for related party transactions should be considered in relation to the activities of publicly traded companies within company groups and the management of conflicts of interest. If not properly regulated, these operations, particularly within such group structures, may jeopardise market confidence. The assessment of the framework for related party transactions may reveal whether there are gaps or loopholes when these are conducted within corporate groups, and they should be taken into account in relation to Principle I.H. The potential abuse of related party transactions is an important policy issue in all markets, but particularly in those where corporate ownership is concentrated, and corporate groups prevail. Complicated group structures may increase the opaqueness inherent in related party transactions and the possibility of circumventing disclosure requirements. Furthermore, in publicly traded companies within company groups, the duty of loyalty of a board member might be ambiguous and even interpreted as to the group, although the duty of loyalty of a board member is to the company and all of its shareholders and not to the controlling company of the group. Important elements to examine in conjunction with Principle I.H. concerning related party transactions are treated in more detail under various other principles: sub-Principles II.F.1. and II.F.2. on the approval and conduct of related party transactions, including proper management of conflicts of interest; Principle II.G. on minority shareholder protections against abusive self-dealing; sub-Principle IV.A.7. on disclosure of related party transactions; and sub-Principle V.D.7. on the role of the board in monitoring and managing potential conflicts of interest, including related party transactions.

A final element to take into consideration is the level of co-operation between domestic regulators and other jurisdictions. As publicly traded companies within company groups often operate in different sectors and across borders, such co-operation, including information sharing on the activities of corporate groups, can help to strengthen the effectiveness and consistency of regulatory oversight. When publicly traded companies within company groups of a jurisdiction operate commonly across borders, this co-operation is even more important.

Essential criteria

1) Does the legal framework clearly define company groups and the criteria applied for the oversight of publicly traded companies within such groups?
2) If there are multiple definitions provided in different laws and regulations, are they coherent and consistent with each other, and are the respective roles and responsibilities of different enforcement authorities clearly allocated to ensure effective enforceability of regulatory provisions applying to publicly traded companies within company groups?

Chapter II: The rights and equitable treatment of shareholders and key ownership functions

Introduction

The overarching principle of Chapter II states that: "The corporate governance framework should protect and facilitate the exercise of shareholder's rights and 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 at a reasonable cost and without excessive delay." The outcome advocated by this principle covers what are agreed to be fundamental shareholder rights to ensure the integrity and efficiency of equity markets.

In some jurisdictions shareholder rights are very closely defined and there is little room for variation across companies. This makes an assessment easier. In other jurisdictions, shareholder rights might only be generally specified in the law and jurisprudence and are essentially determined by company bylaws or articles of association. The assessment will therefore need to take into account the various practices in a jurisdiction and whether the majority of companies implement the shareholder rights provisions of the Principles.

The desired outcome of this overarching principle is also to preserve trust in capital markets by protecting non-controlling shareholders from potential abuse such as misappropriation by boards, managers and controlling shareholders. Investors' confidence that their interests will not be subject to abuse will encourage investments, lower capital costs and raise the value of equity.

The annotation to the principle notes that in protecting investors, a distinction can be made between *ex-ante* and *ex-post* shareholders rights, and this distinction can be usefully applied during an assessment. *Ex-ante* rights are, for example, pre-emptive rights and qualified majorities for certain decisions. *Ex-post* rights cover access to redress once rights have been violated. The annotations indicate that the balance between *ex-ante* and *ex-post* rights will likely vary between jurisdictions so that a reviewer will need to be particularly sensitive to functional equivalence in forming a judgement about whether the principle has been implemented. This is particularly important with respect to whether shareholders can obtain redress for grievances at a reasonable cost and without excessive delay. In forming a judgement about the *ex-post* aspect of shareholder rights, attention will also need to be paid to the avoidance of excessive litigation. Many countries protect management and board members from the abuse of litigation through screening mechanisms, such as a pre-trial procedure to evaluate whether the claim is non-meritorious or through safe harbours such as the business judgement rule. It is important also to ensure that rules are adapted to take account of the structure of ownership and control and legal system in a jurisdiction, e.g. certain remedies provided for in the law may not work effectively in a jurisdiction that lacks a critical mass of significant minority shareholders with an ability to exercise their rights or courts with efficient judicial processes and/or sufficient commercial expertise.

Enforcement of shareholder rights and the opportunity to obtain effective redress at reasonable cost and without excessive delay should be evaluated by a reviewer in conjunction with all recommendations of Chapter II. This assessment should also consider the overall corporate governance framework beyond Chapter II and take into due account information collected under Part B on the institutional framework, Part C for Chapter I concerning the corporate landscape and indicators on how effectively court systems function in terms of time and costs, their reliability and transparency as well as the expertise of judges to understand technical corporate cases and achieve fair and transparent rulings. This evaluation calls for considering enforcement of shareholder as well as stakeholder rights, and in the analysis of likely practices to be examined, a reviewer may also try to measure, using available external datasets, the average time and cost to obtain redress for shareholders and stakeholders.

To complement this information and building on the information and data collected under Parts B and C, the reviewer will also need to examine the experience with methods of enforcement other than litigation by shareholders. Many jurisdictions' enforcement frameworks are based on the view that alternative procedures, such as administrative hearings or arbitration procedures organised by the securities regulators or other bodies, are an efficient method, at least in the first instance, to ensure shareholder rights protection and effective redress.

Issues and assessment criteria

Principle II.A.: Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; 6) share in the profits of the corporation; and 7) elect, appoint or approve the external auditor.

Relevant cross references to assess sub-Principle II.A.:

Principle II.C.

Principle II.A. is assessed based on its seven sub-Principles and should be checked for consistency with the assessment of Principle II.C. which further refines the basic rights of shareholders.

Sub-Principle II.A.1.: Secure methods of ownership registration.

Likely practices to be examined

Secure methods of ownership registration are a fundamental aspect to enable shareholders to exercise their rights. Methods of ownership registration are generally recognised in the law, and to function effectively, the jurisdiction must be able to rely on a central securities depository or register of dematerialised securities. When clear methods for ownership registration are lacking, companies may experience cases of new shareholders appearing overnight or other cases in which investors have discovered that their shares had not been registered. When such practices appear to be relatively common, or too easy to perpetrate, it is an indication that sub-Principle II.A.1. should be assessed as either not, or as only partly, implemented. In other cases, companies have discovered that the register of record shareholders has exceeded the total shares issued by the company due, for instance, to double booking by brokers that indicates a systemic flaw. Some jurisdictions also permit bearer shares which can raise other issues such as their *prima facie* acceptance at a shareholders meeting and knowledge on the part of other shareholders that such shares have been issued. In many jurisdictions, shares are held by a chain of intermediaries and custodians. Companies need to have confidence in the ability of intermediaries to maintain accurate records and shareholders confidence that their property is properly protected. Where securities can be dematerialised (e.g. electronic form) and transferred by book entry, the system should be widespread and reliable. There should be minimum performance standards for registrars/transfer agents, such as recordkeeping rules, as well as the possibility of inspection and examination of registrars/transfer agents by the authorities. Companies or their agents are liable for maintaining an accurate register of shareholders.

When ownership records are not accurate, shareholders should also be empowered with effective means of redress, i.e. such as court petitions for rectification or lawsuits against corporate officers involved.

Essential criteria

1) Are listed companies required to (and do in practice) maintain, preferably via a centralised securities depository or dematerialised securities registry, or alternatively by themselves or through an agent, a register of record shareholders (or in the case of bearer shares, a register of shares issued)? Can any shareholder or a party acting on the shareholder's behalf inspect the list of shareholders to verify their holdings?
2) If shares are held on behalf of shareholders by custodians and/or depositories, are shareholder rights in such shares sufficiently protected and do they safeguard customers' assets?[1]

3) For dematerialised securities, do shareholders and market participants consider the system as reliable and accessible?

Sub-Principle II.A.2.: Convey or transfer of shares.

Likely practices to be examined

As a general matter, shareholders of publicly traded companies should expect to be able to freely transfer their shares and this right usually needs to be underpinned by an effective clearing and settlement framework. The reviewer should solicit the opinions of market participants to judge whether or not the clearing and settlement framework functions effectively. This is a highly complex area with its own set of international standards (e.g. Committee on Payment and Settlement Systems/IOSCO) so a reviewer might also benefit from consulting any specialised review already conducted.

In practice, many jurisdictions permit public companies to restrict the transfer of shares such as where they have been pledged as collateral. Some jurisdictions also allow a company to refuse registration unless it knows the identity of the new owner and in some jurisdictions the transfer can be restricted in company articles of association or bylaws. The Principles require the disclosure of material information on major share ownership, including beneficial owners. Where refusal to register share transfers can be part of a company's articles of association or bylaws and is widespread, the jurisdiction should be assessed as either not implementing the sub-Principle or as only partly implementing (when such provisions are possible but seldom used in practice).

The authorities also have a legitimate interest in being able to restrict or prohibit the transfer of shares. This is particularly so in the case of financial institutions where the prudential requirements might need to be enforced by limiting transferability. The enforcement of competition policy and takeover rules are also legitimate reasons for the authorities to prevent transfers. Some securities regulators may place restrictions on shareholders' ability to resell their securities in the public markets if the securities were sold in the first instance pursuant to certain exemptions from securities registration requirements. The existence of such restrictions should therefore not lead to an assessment of non-implementation of the sub-Principle.

A number of jurisdictions have restrictions on ownership by foreign investors either in general or in particular sectors such as those involving national security. In some cases, there are requirements that no more than a particular percentage of outstanding shares can be owned by foreign investors. Such policy action should not form part of an assessment. In the preamble to Chapter II, it is noted that: "The Principles support equal treatment of foreign and domestic shareholders in corporate governance. They do not address policies to regulate foreign direct investment". However, the concern of the Principles to ensure effective corporate governance would indicate a need by the authorities to assess the benefits of the investment policy against the side effects on corporate governance. This issue could be taken up in the final report as a policy issue to be discussed. Restrictions widely regarded as legitimate in the international community may be imposed by the authorities subject to transparent rule making and appeals procedures.

Essential criteria

1) Are shareholders generally able to transfer or convey shares freely? If listed companies restrict the transfer or conveyance of shares in certain cases, either as a consequence of laws, listing requirements and/or market discipline, are such restrictions for well-justified reasons?
2) Are the securities depositaries adequately staffed and funded, independent of special interests and accepted by market participants? Is the clearing and settlement framework regarded by market participants as functioning effectively?

Sub-Principle II.A.3.: Obtain relevant and material information on the corporation on a timely and regular basis.

Relevant cross references to assess sub-Principle II.A.3.:
Sub-Principle II.C.1., sub-Principle II.C.2., Principle IV.A.

Likely practices to be examined

Companies have an obligation to make relevant and material information available directly to shareholders or their representatives, including through web sites. Shares are often held on behalf of shareholders by intermediaries so that the issue in practice arises whether they are required to (and do in practice) transmit material received from companies to shareholders in a timely manner (unless shareholders have expressly requested that such material not be transmitted to them). In some jurisdictions, it has been observed that companies might restrict access by having shareholder meetings on an irregular basis. Where this is widespread, the jurisdiction should be assessed as either not or only partly implementing the sub-Principle. The assessment should be consistent with that under Principle IV.A. concerning disclosure of material information. The type of information that should be readily available includes, but is not limited to, company articles of association/bylaws, financial statements, minutes of shareholder meetings and the capital structure of the company.

Essential criteria

1) Can shareholders or their representatives obtain relevant and material company information without undue delay and cost?
2) Is shareholders' access to material information unimpeded by internal company procedural or legal mechanisms?

Sub-Principle II.A.4.: Participate and vote in general shareholder meetings.

Relevant cross references to assess sub-Principle II.A.4.:
Sub-Principle II.C.2., sub-Principle II.C.3., sub-Principle II.C.6., Principle II.E.

Likely practices to be examined

Shareholders' right to engage in general meetings by participating and voting is a fundamental aspect and may be assessed based on the legal framework as well as company practices. Such rights are generally clearly recognised and spelled out in the main company law or civil code, depending on the jurisdiction.

Cases that may raise concerns for a reviewer occur where shareholder participation and voting are impeded by the misuse of procedural rules and bylaws such as voting pre-registration and share blocking rules. The reviewer should consult the investor community, the securities regulator, stock exchange(s), etc., about such practices. Where they are used by a significant number of listed companies, including very large and prominent companies, the reviewer should be inclined to view that the sub-Principle is only partly implemented due to a deficient legal framework and/or enforcement. Different meeting formats which allow for shareholders' remote participation in line with sub-Principle II.C.3. may entail different procedures for posing questions and/or voting. The reviewer may take into account whether obstacles are imposed by the framework and/or in practice as well as whether shareholder questions submitted remotely are treated differently, compared to in-person participation.

Many jurisdictions permit classes of shares that exclude the holders of those shares from participating and voting in the general meeting of shareholders, for example shares with limited voting rights or preference shares which give right to a preference concerning a company's dividends, while restricting participation

and voting rights. The existence of such classes of shares does not imply that the sub-Principle is not implemented since the Principles do foresee different classes of shares and is not prescriptive about the respective rights. When there are different classes of shares, the Principles underline that within the same series of a class, all shareholders should be treated in an equal manner.

Essential criteria

1) Are shareholders entitled to participate and vote in a general shareholder meeting without having their rights impeded by procedural and/or legal mechanisms available to a company?

Sub-Principle II.A.5.: Elect and remove members of the board.

Relevant cross references to assess sub-Principle II A.5.:

Sub-Principle II.C.5.

Likely practices to be examined

The right to elect and remove members of the board is generally clearly provided for in the law, either the main company law or civil code or other law applicable to listed companies. In jurisdictions with a two-tier board structure, this sub-Principle is intended to analyse whether shareholders have the right to elect and remove members of the supervisory board.

Of concern to a reviewer is whether there is widespread resort to procedures that are designed to restrict the legitimate right of shareholders to elect or remove members of the board. The reviewer should consult the investor community, securities regulator, stock exchange(s), etc., about such practices. Where they are used by a significant number of listed companies, including very large and prominent companies, the reviewer should be inclined to view that the sub-Principle is only partly implemented due to a deficient legal framework and/or enforcement. Some jurisdictions permit classes of shares that exclude the holders of those shares from certain corporate decisions, as electing and removing members of the board, restricting any participation to extra-ordinary meetings or limiting voting rights. The existence of such classes of shares does not imply that the sub-Principle is not implemented since the Principles do foresee different classes of shares and is not prescriptive about the rights.

Essential criteria

1) Can shareholders with voting rights elect and remove members of the board without having their rights impeded by procedural and/or legal mechanisms available to a company?

Sub-Principle II.A.6.: Share in the profits of the corporation.

Relevant cross references to assess sub-Principle II.A.6.:

Principle II.E.

Likely practices to be examined

Different classes of shares may have a different priority of claims with respect to the profits of a corporation. Most jurisdictions permit the issuance of a class of shares (e.g. preference shares) with a right to dividends as a priority in comparison with other shareholders. The mere existence of such shares should not lead the reviewer to conclude that the sub-Principle is not observed or only partly observed. The reviewer should, however, be aware of cases where dividends have been paid on a more or less *ad hoc* basis to individual shareholders and the procedures or lack of enforcement that have facilitated such behaviour.

Company laws vary greatly with respect to who decides on the distribution of profits and the Principles are neutral as regards the system. To cover all eventualities, a general criterion is useful, emphasising the absence of effective barriers and a transparent process.

Essential criteria

1) Are shareholders in the same share class treated equally and in accordance with the rights of the share class with respect to the distribution of profits?
2) Is there a transparent and enforceable legal framework defining how decisions are made about the distribution of profits?

Sub-Principle II.A.7.: elect, appoint or approve the external auditor.

Relevant cross references to assess sub-Principle II.A.7.:
Sub-Principle II.C.4., Principle IV.C., Principle IV.D.

Likely practices to be examined

Nearly all jurisdictions with significant stock markets have established shareholders' right of election, appointment or approval of the external auditor in their laws. Audit committees are as a rule involved and support the process, in the form of a recommendation or nomination of the external auditor. It is also common for boards to play a role, being often required to recommend suitable candidates for shareholder final approval, ratification or certification. This sub-Principle contains no annotations but the appointment process should also be assessed against Principle IV.C. on external audit and IV.D. on the accountability of external auditors to shareholders, where the annotations clarify that it can be regarded as good practice for external auditors to be elected, appointed or approved either by the shareholders meeting directly or by an independent audit committee of the board or equivalent body. The external auditor appointment process can help evaluate the level of independence, ethical conduct, accountability to shareholders of external auditors as well as the conduct of audit in the public interest. While there are different possible frameworks for the process to select the external auditor, the reviewer should evaluate whether shareholders have a say in the process according to the legal framework and whether this right is respected in practice.

Essential criteria

1) Can shareholders elect, appoint or approve the external auditor (with the support of boards/audit committees or equivalent body pursuant to the specific framework)?

Principle II.B.: Shareholders should be sufficiently informed about, and have the right to approve or participate in 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, including the transfer of corporate assets that in effect result in the sale of the company.

Likely practices to be examined

Principle II.B. addresses the most basic issues surrounding a company. Company law and practices, however, differ markedly around the world: some jurisdictions give full rights to shareholders to propose and to change the governing documents of a company, in others they can only vote on a proposal of the board, and in some it depends on the bylaws of the company. In other jurisdictions, boards can decide on

the changes themselves. In some jurisdictions it is common for boards to have delegated authority to substantially increase the outstanding shares, while in others, the need for the decision to be taken by shareholders results in limited board authority.

In forming an assessment of whether sub-Principles II.B.1., II.B.2. and II.B.3. are observed, it is important to bear in mind that the Principle calls for shareholder approval or participation rights and that they be sufficiently informed about these fundamental corporate decisions. Thus, a situation where they can only vote on a recommendation of the board should be considered as a case where the Principle is implemented, unless supplemented by other evidence and concerns voiced by investors and market participants. On the other hand, when shareholders cannot vote at all, the Principle should be assessed as not implemented. The second aspect, that shareholders be sufficiently informed, is based on two fundamental aspects of the Principles: shareholders should be informed when taking decisions and they should also have full *ex-ante* information about aspects limiting their rights that would normally be factored into the price of the security.

Sub-Principle II.B.1.: Amendments to the statutes or articles of incorporation or similar governing documents of the company.

Likely practices to be examined

The right to adopt and change basic corporate documents is generally provided for in the legal framework. Procedural rules adopted by companies should not frustrate the exercise of these rights and material information must be provided sufficiently in advance of meetings to allow sufficient time to properly consider decisions. A reviewer should understand whether shareholder rights in this area are not restricted in practice, for example by preventing their participation in the decision process or by providing insufficient information on the proposed actions.

Essential criteria

1) Does the legal framework require shareholder approval for changes to the basic governing documents of the company?

Sub-Principle II.B.2.: The authorisation of additional shares.

Likely practices to be examined

The right to authorise and issue new shares should be clearly provided in the legal framework. A reviewer should consider it permissible for shareholders to delegate this authority for a limited period. Procedural rules adopted by companies should not frustrate the exercise of these rights and full information must be provided sufficiently in advance of the meeting to permit considered decisions.

Essential criteria

1) Does the corporate governance framework require shareholder approval for changes to the authorised capital of the company?

Sub-Principle II.B.3.: Extraordinary transactions, including the transfer of corporate assets, that in effect result in the sale of the company.

Likely practices to be examined

The right to approve extraordinary transactions should be clearly provided in the legal framework and be granted to shareholders in practice. Material information about the proposed transaction must be provided sufficiently in advance of the meeting to permit considered decisions.

Essential criteria

1) Does the corporate governance framework either give exclusive power to the shareholder meeting or requires the board to seek shareholder approval of extraordinary transactions, including transfer of corporate assets, which in effect result in the sale of the company?

Principle II.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.

Likely practices to be examined

In practice, numerous procedures might be used to reduce the effectiveness of shareholder participation, especially those that can be manipulated on an *ad hoc* basis and therefore would not be incorporated into the share price of a company by informed investors. Instances of *ad hoc* devices used to mute shareholder voice include voting by show of hands without the right to demand a ballot, granting only a limited number of entry cards to custodians, delaying information, and holding the shareholder meeting in a remote or unknown location. Many of the rules and procedures are only in part determined by law and regulation. They are rather often heavily influenced by the board through corporate bylaws. The reviewer must therefore be aware of general practices in the jurisdiction by collecting and considering information from investors and other market participants. Assessment of the more specific sub-Principles II.C.1. through II.C.7. are also relevant for an overall assessment of Principle II.C.

Sub-Principle II.C.1.: Shareholders should be furnished with sufficient and timely information concerning the date, format, location and agenda of general meetings, as well as fully detailed and timely information regarding the issues to be decided at the meeting.

Relevant cross references to assess sub-Principle II.C.1.:
Sub-Principle II.A.3., sub-Principle II.C.3.

Likely practices to be examined

In most jurisdictions, law or regulation specifies a minimum notice period prior to general shareholder meetings. Among OECD and G20 jurisdictions, the notice period ranges most commonly from 15 to 21 days, but some jurisdictions adopt longer periods. Companies can increase the notice period and, in some jurisdictions, corporate governance codes do call for longer periods than the legal minimum. The appropriate length of the notice period will in part depend on the importance of the issues to be decided as well as on the nature of the shareholding structure. Most jurisdictions also specify such notices to be sent to all shareholders. With many shares held through a chain of intermediaries, there seems to be a consensus that a longer period of minimum notice is necessary for shareholders both to make their decisions and then to communicate their decisions to the company through the chain of intermediaries. Furthermore, the availability and use of electronic means for the delivery of material and for voting in the

jurisdiction will also need to be taken into consideration. The format in which a meeting will take place, either in person, virtually or both (in a hybrid format) should also be clarified in the information provided to shareholders, to allow them to choose how to attend such meeting and make necessary arrangements in due time. The information included in a meeting notice is therefore relevant, in particular, with the evolution of meeting formats. To support informed shareholder voting, this may include information on how to access online platforms for shareholder meetings, technological solutions adopted for voting and nominating proxies, as well as disclosure of reports accounting for remuneration, sustainability or compliance with codes' recommendations. The venue of the meeting is also important, and jurisdictions adopt varied approaches to identify the location for fully virtual shareholder meetings.

More and more jurisdictions require multiple methods of notification which in addition to direct notification may also include use of a stock exchange or regulator's electronic platform, and publication on the company's website or in a newspaper. Many listed companies make shareholder meeting material freely available on their websites or on the stock exchange's website, and/or there is a free, internet-based and easily accessible public register of listed companies' meeting material.

Considerable judgement will therefore be required of reviewers to determine the situations where companies are in fact manipulating shareholder rights through insufficient time and insufficient information for shareholders to form a judgement. This will involve extensive discussions with investors to see whether they are comfortable with the general behaviour of companies in a jurisdiction.

Another practice that has often been observed and that reduces shareholder participation involves uncertainty about a meeting date. In some jurisdictions that specify quorums for a general meeting of shareholders, companies may make a first announcement of a meeting but will then change it at short notice to another date upon indications that there may not be a quorum. While this is in theory legitimate, it can also limit participation and be used to dissuade some shareholders from participating. Furthermore, meeting dates concentrated in a limited amount of time may make it challenging for shareholders to participate in all meetings, and the possibility to attend remotely via hybrid or virtual meetings may facilitate attendance in some cases. Overall, based on the legal framework and observed practices, a reviewer should consider the sub-Principle as generally observed in the jurisdiction if investors acknowledge that notice and information provided by companies is timely and adequately informative.

Essential criteria

1) Does the corporate governance framework require or encourage companies to provide sufficient advance notice of shareholder meetings and to deliver fully detailed meeting materials covering the meeting, including its format, location and issues to be decided)?

Sub-Principle II.C.2.: Processes, format 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.

Relevant cross references to assess sub-Principle II.C.2.:

Sub-Principle II.A.3., sub-Principle II.A.4., sub-Principle II.C.1., sub-Principle II.C.3.

The intent of sub-Principle II.C.2. is that all shareholders are entitled to participate at the general meeting of shareholders in accordance with the rights of the respective share class. Rights to be exercised for different classes of shares might vary between general and extraordinary meetings but this practice is within the meaning of the Principles.

Likely practices to be examined

The company's management and controlling investors have been observed at times to discourage non-controlling and foreign investors from trying to influence the direction of the company. The annotations list a series of potential practices that may undermine shareholder participation and equitable treatment of all shareholders and note that "Some companies have charged fees for voting. Other potential impediments include prohibitions on proxy voting, requiring personal attendance at general shareholder meetings to vote, bundling of unrelated resolutions, holding the meeting in a remote location, and allowing voting by show of hands only." This list of practices is not exhaustive and other procedures may make it practically impossible or cumbersome to exercise ownership rights. The experience of investors in the jurisdiction and their concerns should be considered.

Voting materials may be sent too close to the time of general shareholder meetings to allow investors adequate time for reflection and consultation (see sub-Principles II.A.3. and II.C.1. for a consistency check). Depending on how widespread the practices are judged to be, the reviewer should conclude that the sub-Principle is only partly implemented. In making an assessment, the reviewer should seek the opinions and experience of, among others, proxy agencies and investors.

In some companies and jurisdictions, it is the practice at general shareholder meetings to obtain the voting intentions of the largest shareholders first and, as soon as there is a clear majority, to disregard and not count the remainder. For the sub-Principle to be judged as implemented, it is important that the corporate governance framework ensures that all votes cast are counted equally and that the results of all votes cast in whatever form are registered.

Most jurisdictions prescribe a formal procedure of vote counting and require listed companies to publish voting results promptly (generally within five days) after the general meeting, with information on voting outcomes and often also details on percentage of votes for or against resolutions and the number of abstentions. Some jurisdictions also provide voting confirmations to shareholders who cast their votes, to confirm that the vote has been duly taken into account.

Essential criteria

1) Does the corporate governance framework require or encourage publicly traded companies to: (a) facilitate voting by minimising the costs involved for shareholders; (b) use voting methods at shareholder meetings that ensure the equitable treatment of shareholders; and (c) make voting results available to shareholders on a reliable and timely basis?
2) Do procedures adopted by publicly traded companies to determine voting rights avoid creating a disincentive to the exercise of ownership rights by investors, both domestic and foreign?

Sub-Principle II.C.3.: General shareholder meetings allowing for remote shareholder participation should be permitted by jurisdictions as a means to facilitate and reduce the costs to shareholders of participation and engagement. Such meetings should be conducted in a manner that ensures equal access to information and opportunities for participation of all shareholders.

Relevant cross references to assess sub-Principle II.C.3.:

Sub-Principle II.C.2., sub-Principle II.C.4., sub-Principle II.C.6., sub-Principle II.C.7.

This sub-Principle addresses remote participation in meetings. Remote participation can take place through virtual meetings (where all shareholders attend the meeting virtually) or through hybrid meetings (where some shareholders attend the meeting physically and others virtually).

Likely practices to be examined

Remote meetings and physical meetings should provide the same opportunities for participation and engagement of shareholders. The sub-Principle aims to determine whether remote and in-person attendance of meetings ensure equal participation (i.e. possibility to ask questions and receive responses, to access information and make comments) during shareholder meetings. For this reason, the assessment should take due note of findings and essential criteria for Principle II.C. and its other sub-Principles. Furthermore, sub-Principle II.C.3. does not aim to evaluate the possibility of voting remotely which can be assessed, when provided, with reference to sub-Principle II.C.7.

A reviewer should consider that remote meetings, when allowed by the legal framework or adopted by companies, require due care to ensure that they do not decrease accountability, by discouraging the possibility for shareholders to engage with and ask questions to boards and management. The first step for an assessor would be to determine the legal framework for remote meetings, whether these are allowed in virtual and/or hybrid format and whether the framework is sufficiently clear on these aspects. In some jurisdictions, when fully virtual meetings are allowed, the law may require companies to seek shareholder approval and limit the validity of such approval to a limited number of years (e.g., three to five years) to ensure shareholders are comfortable with virtual only participation as conditions evolve.

The corporate governance code and other guidelines and recommendations may also address remote meetings. These recommendations can be issued by supervisory and regulatory authorities, SROs or corporate governance-dedicated associations. The possibility of holding virtual or hybrid meetings can also be left to each company's discretion and subject to specific provisions in the company's articles of association or bylaws. The framework, when adopted, should be sufficiently clear regarding the type(s) of remote participation allowed and, importantly, whether fully virtual meetings without any physical attendance can take place. The feedback of investors, companies and service providers will be in any case an important complement, including to understand the extent to which remote meetings have been taking place in practice.

Remote meetings take place through dedicated virtual platforms which are offered by technology vendors and providers to manage remote participation. In this regard, the annotations further specify that "When choosing service providers, it is important to consider that they have the appropriate professionalism as well as data handling and digital security capacity to support the conduct of fair and transparent shareholder meetings, with technical and organisational security measures in place for each of the processing operations carried out by virtue of their service, especially concerning personal data, which require stricter security measures. Such processes should allow for the verification of shareholders' identity through secured authentication of attendees and ensure equal participation as well as the confidentiality and security of votes cast prior to the meeting." To understand whether investors are able to attend meetings remotely and the platforms provided for such purpose are sufficiently professional and reliable, the assessor will also have to collect the feedback and experience of participating investors and companies. The information may also help shed light on common practical issues and technical failures which may impair shareholder participation and engagement, in comparison to physical attendance.

The annotations further point to the value of facilitating the conduct of remote meetings. For this purpose, the annotations specify that "Some jurisdictions have issued guidance to facilitate the conduct of remote meetings, including for handling shareholder questions, responses and their disclosure, with the objective of ensuring transparent consideration of questions by boards and management, including how questions are collected, combined, answered and disclosed. Such guidance may also address how to deal with technological disruptions that may impede virtual access to meetings." Adopting guidance at the jurisdiction or company level may not be necessary and if not adopted, the sub-Principle should not be considered as not implemented. However, when there is evidence suggesting that remote meetings do not ensure equal access to information and opportunities for participation to all shareholders, the lack of guidance may reinforce the assessor's view that sub-Principle II.C.3. is not or only partly implemented.

Essential criteria

1) Does the legal framework allow for remote participation in general shareholder meetings via virtual and/or hybrid meetings for listed companies? If yes, does the framework specify clearly under which conditions, if any, are fully virtual or hybrid meetings allowed?
2) When remote participation is allowed, is there any required or recommended safeguard in place to ensure equal participation of shareholders, regardless of the format of the meeting? In the absence of such guidance, do shareholders participating remotely have the same access to participate and vote in general meetings as in person participants?

Sub-Principle II.C.4.: Shareholders should have the opportunity to ask questions to the board, including on the annual external audit, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.

Relevant cross references to assess sub-Principle II.C.4.:
Sub-Principle II.A.7., sub-Principle II.C.2., sub-Principle II.C.3., Principle II.D.

Likely practices to be examined

Evidence has indicated that shareholders may be effectively prevented from posing questions to the board through techniques such as written notice being required a long time in advance of a meeting of shareholders and through unreasonably high (relative to the average size of companies) individual or collective shareholding requirements for questions. Share blocking, a system that requires shareholders who vote or have registered to vote not to dispose of their shares for a period of time (sometimes until after the meeting), or registration periods may also be used to effectively prevent questions. The annotations also note that the right to ask questions should be coupled with appropriate replies from management and board members in a manner that ensures their transparency. The reviewer should also consider whether posing questions, is allowed or common practice when meetings are conducted remotely (for a consistency check, sub-Principle II.C.3. and its essential criteria should be analysed together). The assessor will have to form a judgement about whether actual practices are on balance fair or are used to prevent accountability of the board to all shareholders, a key requirement of Chapter II. Furthermore, questions directly proposed to auditors during shareholder meetings are allowed in some jurisdictions especially where they have been appointed by the shareholders. The shareholders' role in appointing the external auditor is evaluated under sub-Principle II.A.7. The right to ask questions on the annual external audit takes the general position that accountability of the board requires that shareholders should be able to ask questions to the board about the external audit.

Minority shareholder rights to place items on the agenda of the general meeting are recognised in most jurisdictions. The ownership threshold for placing items on the agenda is often lower than for convening an extraordinary meeting and is a tool to enable discussions on topics deemed relevant by minority shareholders. The assessment with respect to placing items on the agenda and proposing resolutions will need to adapt to the legal and structural features of the jurisdiction. In some jurisdictions, shareholders can, through an ordinary or extraordinary meeting of shareholders, control the actions of the board. In other jurisdictions, certain matters are viewed as more appropriate for board decision making than shareholder consideration, and this dichotomy is often reflected in legal requirements. The annotations to this sub-Principle note that "[…] It is reasonable, for example, to require that in order for shareholder resolutions to be placed on the agenda, they need to be supported by shareholders holding a specified market value or percentage of shares or voting rights. This threshold should be determined taking into account the degree of ownership concentration, in order to ensure that minority shareholders are not effectively prevented from putting any items on the agenda." The intent of the sub-Principle is that this threshold should be able to include a number of co-operating shareholders, an intent given specific form through Principle II.D.

Proposal of new resolutions during a shareholder meeting may also be allowed, and jurisdictions tend to impose some safeguards, such as a minimum shareholding and/or limit proposals to issues already included into the agenda.

Essential criteria

1) Does the corporate governance framework require or encourage companies to: (a) facilitate shareholders asking questions to the board (regardless of a meeting's format); and (b) permit shareholders to propose items for discussion on the agenda; and/or (c) to submit proposals/resolutions for consideration at the meeting of shareholders? Where voluntary, is the practice widespread?
2) Are thresholds for share ownership establishing the right of individual shareholders, or groups of shareholders, to pose questions, to place items on the agenda or to submit proposals/resolutions for consideration at the meeting of shareholders not too restrictive, taking into account the concentration of ownership in the jurisdiction and the average size of companies?

Sub-Principle II.C.5.: Effective shareholder participation in key corporate governance decisions, such as the nomination and election of board members, should be facilitated. Shareholders should be able to make their views known, including through votes at shareholder meetings, on the remuneration of board members and/or key executives, as applicable. The equity component of compensation schemes for board members and employees should be subject to shareholder approval.

Relevant cross references to assess sub-Principle II.C.5.:

Sub-Principle II.A.5., sub-Principle II.C.1., sub-Principle II.C.2., sub-Principle II.C.6.; Principle III.B., sub-Principle IV.A.5., sub-Principle IV.A.6., sub-Principle V.D.6., sub-Principle V.E.1.

Likely practices to be examined

Concerning the basic shareholder right to nominate and elect board members, in some jurisdictions, shareholders can only cast a vote in favour of the whole list of candidates for the board and not for or against individuals or lists of individuals, or abstain from voting. A jurisdiction in which a large number of companies adopt such a system should be classified as not implementing this sub-Principle. The annotations to sub-Principle II.C.5. state that "For the election process to be effective, shareholders should be able to participate in the nomination of board members and vote on individual nominees or on different lists of them."

The facilitation of effective shareholder participation is taken up in a number of complementary principles covering voting and counting procedures as well as access to relevant information and voting materials.

A key issue is how to judge whether shareholder participation is indeed effective in practice. One indicator might the number of board members formally declared as independent or, in some jurisdictions, nominated and elected by minority shareholders. Another indicator might be the number of contested elections in a jurisdiction, although if a company feels that a nomination might not be acceptable it might simply be withdrawn or not even considered. The judgement of the investor community will in any case need to be an important input for the reviewer. For shareholder participation to be effective, it is also important for shareholders to be informed about nominated board members. The annotations mention that "the Principles also call for full and timely disclosure of the experience and background of candidates for the board and the nomination process, which will allow an informed assessment of the abilities and suitability of each candidate. It is required or considered good practice in some jurisdictions to also disclose information about any other board positions or committee memberships that nominees hold and, in some

jurisdictions, also positions that they are nominated for.” This is aligned with sub-Principle IV.A.5., which calls for disclosure about the composition of the board and its members, with information on their qualifications, the selection process, including other company directorships and their independence. Most jurisdictions have relevant provisions or recommendations for disclosure of relevant information to shareholders about board candidates. It is considered good practice to also disclose information about any other board positions that nominees hold, and in some jurisdictions also positions that they are nominated for. Where there is no adequate disclosure, the assessment of II.C.5. might need to be adjusted accordingly.

The procedures for the nomination of candidates vary widely and in this area, there are a number of functional equivalents that the reviewer might need to consider. When jurisdictions set a minimum shareholding requirement for a shareholder to nominate, which could be set at the same level as the shareholders’ right to place items on the agenda of general meetings, the sub-Principle should not be considered as not or partly implemented. Most jurisdictions establish majority voting for board appointments, more often of individual candidates than slates. Many jurisdictions adopt cumulative voting as well. A reviewer should analyse the chosen mechanism for board elections and when more practices are available to companies, which one(s) are more common in practice, also taking into account company ownership characteristics of the jurisdiction. For example, in some jurisdictions where ownership is characterised by a number of large shareholdings, formal or informal talks might be held between the chair of the board and the major shareholders to determine a list of practices. In other jurisdictions with concentrated shareholding and powerful owners, several positions might be reserved for minority shareholders. In other cases, especially those where management or the board itself have traditionally controlled board nomination, it is regarded as good practice for independent board members to have a key role in nomination, often by comprising the majority of a nomination committee.

Most jurisdictions recommend nomination committees to be established and often that they be comprised wholly or largely of independent directors. Nomination committees, as noted in the annotations, are considered to facilitate compliance with the nomination process and its transparency, as well as the search for balanced, diverse and competent boards. Screening processes, for example an approval by the nomination committee, are common in most jurisdictions.

This sub-Principle calls for shareholders to be able to make their views known, including through votes at shareholder meetings, on the remuneration of board members and/or key executives, as applicable. This requires the disclosure of remuneration of board members and key executives (see also sub-Principle IV.A.6.). The annotations highlight: “In particular, it is important for shareholders to know the remuneration policy as well as the total value and structure of remuneration arrangements made pursuant to this policy. Shareholders also have an interest in how remuneration and company performance are linked when they assess the capability of the board and the qualities they should seek in nominees for the board.” The annotations recognise that different forms of say-on-pay (binding or advisory vote, *ex-ante* and/or *ex-post*, board members and/or key executives covered, individual and/or aggregate compensation, remuneration policy and/or actual remuneration) “play an important role in conveying the strength and tone of shareholder sentiment to the board.” Taking into account the diversity of board and ownership structures, the reviewer should evaluate the different forms of say-on-pay in terms of their effective impact on remuneration arrangements. The sub-Principle calls for equity schemes to be approved either for individuals or for the scheme as a whole. They should not be subsumed under general approval for a potential increase in issued equity, a practice that should be classified as partial or non- implementation of the sub-Principle. Shareholder approval should also be required for any material changes to existing schemes.

Essential criteria

1) Does the corporate governance framework require or encourage companies to facilitate the effective participation of shareholders in nominating and electing board members? Is the practice of facilitating participation widespread, including through formalised procedures in company bylaws and articles of association?
2) Does the corporate governance framework require or encourage companies to give shareholders the opportunities to make their views known, including through votes at the meeting of shareholders, about the remuneration of board members and/or key executives, as applicable? Are there provisions for shareholders to explicitly approve equity-based compensation schemes and is this power not delegated to the board or a board committee?

Sub-Principle II.C.6.: 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.

Relevant cross references to assess sub-Principle II.C.6.:
Sub-Principle II.C.2., sub-Principle II.C.3., Principle III.B.

Likely practices to be examined

With respect to voting in absentia, it is important that investors can rely on directed proxy voting. The corporate governance framework should ensure that proxies are voted in accordance with the direction of the proxy holder. This aspect is crucial. In jurisdictions where only blank proxies can be sent to the company, the sub-Principle should be regarded as not implemented. Only where a shareholder can mandate a proxy for or against any resolution can the sub-Principle be assessed as fully implemented. Where proxies are held by the board or management for company pension funds and for employee stock ownership plans, the directions for voting should be disclosed and voting records should be kept and be available to plan fiduciaries and regulators as needed to ensure that an equal effect is given to all votes.

Some proxy systems are based on the concept of power of attorney but nevertheless allow a shareholder to vote in absentia. Voting in absentia might also take place through an authorised representative which is quite common in many jurisdictions. Another simple alternative to proxies is sending a vote by mail or by electronic means. The annotations state that “The objective of facilitating shareholder identification and participation suggests that jurisdictions and/or companies promote the enlarged use of information technology in voting, including secure electronic voting in all listed publicly traded companies for both remote and in person meetings.” These are cases of functional equivalence, consistent with implementation of the sub-Principle, so long as such votes are given equal effect. Adoption of one or more of the functionally equivalent range of options by companies is widespread. Some mechanisms may prove in practice to be cumbersome and costly, an issue taken up in sub-Principle II.C.2.

In a number of jurisdictions, voting mechanisms are only generally specified by company law and securities regulation and a great deal will depend on company bylaws, articles of association and practices. In forming a judgement about implementation of the sub-Principle, a reviewer might be able to make use of the numerous surveys conducted by proxy agents and investor groups about the actual practices of companies. Whether shareholders have an effective remedy against the company if it does not provide the options prescribed by law should also be evaluated for a comprehensive analysis.

Essential criteria

1) Does the corporate governance framework permit shareholders to vote in absentia? Can shareholder votes cast in absentia be for or against a resolution, and fully equivalent to the votes of shareholders voting in person?

Sub-Principle II.C.7.: Impediments to cross-border voting should be eliminated.

Likely practices to be examined

The annotations state that “Foreign investors often hold their shares through chains of intermediaries. Shares are typically held in accounts with securities intermediaries who in turn hold accounts with other intermediaries and central securities depositories in other jurisdictions, while the publicly traded company resides in a third jurisdiction. Such cross-border chains result in special challenges with respect to determining the entitlement of foreign investors to use their voting rights, and the process of communicating with such investors.” In particular, there is often confusion about who is legally entitled to control the arrangements that govern the voting of shares. This has led some jurisdictions to define an “ultimate investor” or beneficial owner and to clarify that they have a legally enforceable right to determine how shares are voted, a measure compatible with implementation of the Principles.

The complex holding chain, together with business practices and regulations that provide only a very short notice period (see sub-Principle II.C.1. and the associated assessment criteria), often leaves shareholders with only very limited time to react to a convening notice by the company and to make informed decisions concerning items for decision. This makes cross-border voting difficult. The annotations highlight that “Moreover, notice periods should ensure that foreign investors in effect have the same opportunities to exercise their ownership functions as domestic investors. To further facilitate voting by foreign investors, laws, regulations and corporate practices should allow participation through electronic means in a non-discriminatory way.” For the assessment, the reviewer is only concerned with domiciled institutions and domestic regulations and practices, and not with foreign practices. Thus, a jurisdiction might be regarded as implementing the sub-Principle even though foreign shareholders continue to experience problems due to deficiencies in other jurisdictions. For example, disputes between foreign shareholders and their global custodian are likely to be adjudicated outside the local market and should not be considered by the reviewer, even if information is available.

Essential criteria

1) Does the legal framework clearly specify who is entitled to control the exercise of voting rights attached to shares held by foreign investors through a chain of intermediaries? Does the corporate governance framework require or encourage companies to provide sufficient notice of meetings to enable foreign investors to have the same opportunities as domestic investors to exercise their voting rights?
2) Are publicly traded companies required or encouraged to make use of secure and effective processes and technologies that facilitate voting by foreign investors, including by allowing participation through electronic means in a non-discriminatory way?

Principle II.D.: Shareholders, including institutional shareholders, should be allowed to consult with each other on issues concerning their basic shareholder rights as defined in the Principles, subject to exceptions to prevent abuse.

Co-ordination problems faced by dispersed shareholders can result in under-monitoring of boards and management (i.e. agency costs). Principle II.D. seeks to address this concern by allowing shareholders to consult and co-ordinate with each other concerning their basic shareholder rights, subject to restrictions to prevent abuse.

Likely practices to be examined

The annotations to Principle II.D. note that shareholders should be allowed and even encouraged to co-operate and co-ordinate their actions in nominating and electing board members, placing proposals on the

agenda and putting questions to the board and management, subject to shareholders' compliance with applicable law, including, for example, beneficial ownership reporting requirements. More generally, shareholders should be allowed to communicate with each other without having to comply with the formalities of proxy facilitation. National stewardship codes may also encourage such collaboration. Shareholder co-operation or co-ordination, however, can also be used to manipulate markets and to obtain control over a company without being subject to take-over regulation. For this reason, in some jurisdictions, shareholders co-operating on their voting strategy are subject to additional regulation. The lack of shareholder and investor groups might indicate that the current system is highly constraining, and individuals and organisations should be consulted to see whether this is the case. The challenge for the reviewer is to ensure a balance between the two concerns which allows sufficient room for legitimate shareholder activity. A well-functioning take-over market, with clearly defined rules about what constitutes seeking control, will go a long way to alleviating concerns about undermining take-over rules and market manipulation.

The annotations to Principle II.D. note that "Safeguards may be needed to prevent anticompetitive behaviour and abusive actions, particularly in jurisdictions where institutional investors are significant owners in publicly traded companies and their co-ordinated actions could have stronger influence on companies' decisions. Disclosure of the co-ordination policy could provide clarity to the market on the scope of such actions. However, if co-operation does not clearly involve issues of corporate control, or conflict with concerns about market efficiency and fairness, the benefits of more effective ownership may still be obtained. To provide clarity among shareholders, regulators may issue guidance on forms of co-ordination and agreements that do or do not constitute such acting in concert in the context of take-over, competition and other rules."

The annotations also note that "Some major institutional investors have established initiatives to facilitate the co-ordination of their engagement, for example to address climate-related concerns." Being able to co-ordinate engagement on such issues when not linked to changes in corporate control, without the risk of being considered as acting in concert, is important for institutional investors. Providing legal clarity to institutional investors on acceptable practices and underlying criteria may be beneficial.

Essential criteria

1) Does the corporate governance framework establish impediments such as unclear rules or guidance for proxy solicitation which prevent shareholders consulting with each other over the use of their basic rights, for example to elect and remove board members?
2) Are market trading rules designed in a way to prevent market manipulation but flexible enough to permit and encourage consultations between shareholders?

Principle II.E.: All shareholders of the same series of a class should be treated equally. All investors should be able to obtain information about the rights attached to all series and classes of shares before they purchase. Any changes in economic or voting rights should be subject to approval by those classes of shares which are negatively affected.

Relevant cross references to assess Principle II.E.:
Sub-Principle IV.A.3., Principle II.H.

Principle II.E. represents a fundamental pillar of equal treatment of shareholders and recognises that all shares should carry the same rights within any series of a class. Most jurisdictions permit companies to issue shares with different rights. With full information about the class and series of shares available at the time of purchase, the share price should normally reflect the different balance of rights and risks.

Likely practices to be examined

The annotations clarify that "Proposals to change the voting rights of different series and classes of shares should be submitted for approval at general shareholder meetings by a specified (normally higher) majority of voting shares in the affected categories." Such guarantees are generally provided for in the law. Where such approval is required, the reviewer should determine whether effective means of redress exist if procedural rules such as adequate notice of a meeting are not followed. Actions detrimental to one group of shareholders could include the board deciding by itself to issue a new class or series of shares or altering the rights of an existing series or class of shares. If this is a common practice, the reviewer should assess the Principle as partly or not implemented. In some cases, shares might acquire increased voting rights after a period of time. To be assessed as fully implemented, such practices must comply with the law, be transparent, non-discriminatory, and included in company bylaws and/or approved by shareholders. In some jurisdictions it might only be possible for investors to obtain information via company bylaws, articles of association or statutes.

An updated summary description of the material attributes of the company's share capital should be made available for publicly traded companies on a regular basis. To meet the intention of the Principle, such access should not be overly difficult to obtain, otherwise the Principle should be judged to be either not or only partly implemented. The latter would be the case if the company updated the material attributes of its share capital regularly such as at its annual meeting of shareholders. Anti-takeover devices might also represent such an abuse, so an assessment would need to be consistent with those for sub-Principle IV.A.3. and Principle II.H.

Essential criteria

1) Does the corporate governance framework require or encourage that proposals to change the voting rights of different series and classes of shares should be submitted for approval at a general meeting of shareholders by a specified (normally higher) majority of voting shares in the affected categories?
2) Does the corporate governance framework require companies to disclose sufficient and relevant information about the material attributes of all of the company's classes and series of shares on a timely basis to prospective investors so that they can make an informed decision about whether or not to purchase shares, and is this information regularly updated to take account of any changes over time?

Principle II.F.: Related party transactions should be approved and conducted in a manner that ensures proper management of conflicts of interest and protects the interests of the company and its shareholders.

Conflicts of interest inherent in related party transactions can increase risks related to the mismanagement and misuse of corporate assets and to the equal treatment of all shareholders. To tackle the complexity and risks posed by these transactions, jurisdictions can adopt a variety of measures, which include appropriate definitions, accounting standards, disclosure *ex-ante* and *ex-post*, specific approval mechanisms, and independent mechanisms to review the fairness of such transactions. Such mechanisms need to be counter-balanced with the need to ensure companies can conclude such transactions when they are recurrent or take place at market terms.

Sub-Principle II.F.1.: Conflicts of interest inherent in related party transactions should be addressed.

Relevant cross references to assess sub-Principle II.F.1.:
Sub-Principle II.F.2., sub-Principle IV.A.4, sub-Principle IV.A.7, sub-Principle V.D.7.

As described in the annotations, "The potential abuse of related party transactions is an important policy issue in all markets, but particularly in those where corporate ownership is concentrated, and corporate groups prevail. Banning these transactions is normally not a solution as there is nothing wrong *per se* with entering into transactions with related parties, provided that the conflicts of interest inherent in those transactions are adequately addressed, including through proper monitoring and disclosure. This is all the more important where significant portions of income and/or costs arise from transactions with related parties."

Likely practices to be examined

The approval process for related party transactions is key to ensure they are concluded on an arm's length basis. As noted in the annotations: "Jurisdictions should put in place an effective framework for clearly flagging these transactions. They should include broad but precise definitions of what is understood to be a related party. They should also include rules to disregard some of these transactions when they are not material because they do not exceed *ex-ante* thresholds, can be regarded as recurrent and taking place at arm's length on verifiable market terms, or take place with subsidiaries where no specific interest of a related party is present. Once the related party transactions have been identified, jurisdictions set procedures for approving them in a manner that minimises their negative potential. In many jurisdictions, great emphasis is placed on board approval supported by the audit committee review, often with a prominent role for independent members. Jurisdictions may also require the board to justify the interest of the transaction for the company and the fairness of its terms. Shareholders may also be given a say in approving certain transactions, with interested shareholders excluded. Many jurisdictions require or recommend as good practice for interested board members to abstain from board decisions on related party transactions."

Shareholder approval for certain related party transactions is most common for large or non-routine transactions or those in which board members have an interest. An opinion or evaluation on the fairness of the transaction's proposed price or value by an external auditor or independent outside specialist is also a common safeguard, in some cases as a precondition for shareholder approval. A review against this sub-Principle should also take into account the practices and essential criteria detailed for sub-Principles IV.A.4. and IV.A.7. on the disclosure of beneficial owners and of related party transactions and V.D.7. addressing board responsibilities.

Essential criteria

1) Are related party transactions clearly and broadly defined and, if so, does the definition capture these transactions in practice?
2) Does the corporate governance framework require or recommend the board (in a two-tier board structure, the supervisory board) or shareholders to formally approve material related party transactions? Are approval procedures in the jurisdiction adequate to minimise the negative potential of related party transactions?

Sub-Principle II.F.2.: Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.

Relevant cross references to assess Sub-Principle II.F.2.:
Sub-Principle II.F.1., Principle II.G., sub-Principle IV.A.7., Principle V.A., sub-Principle V.D.7.

Principle II.F.2. covers internal disclosure of conflicts of interest, meaning a situation that could be abused and therefore needs to be underpinned by strong standards of transparency. It should also be evaluated in conjunction with the effective exercise of fiduciary duties by the board (Principle V.A.).

Likely practices to be examined

Members of the board and key executives should have an obligation to inform the board when they have a business, family or other special relationship outside of the company that could affect their judgement with respect to a particular transaction or matter affecting the company. In jurisdictions with a two-tier board structure, this sub-Principle is intended to determine whether there is a conflict of interest between members of the supervisory and management boards. In some jurisdictions this also applies to controlling shareholders. Such an obligation for members of the board and key executives is also implied by the duty of loyalty, covered in Principle V.A., so that there is a need to ensure that the judgements are consistent. Where a material interest has been declared, the annotations to the sub-Principle note that in many jurisdictions it is good practice for that person not to be involved in any decision involving the transaction or matter and for the decision of the board to be specifically motivated against the presence of such interest and/or to justify the interest of the transaction for the company, notably by mentioning the terms of the transaction.

Practices vary considerably both between jurisdictions and companies. There are cases where thresholds are set rather high for disclosure thereby undermining the intention of the sub-Principle. In other cases, a majority vote by shareholders may decide to exclude a wide variety of transactions from disclosure, effectively undermining implementation of the sub-Principle. In some jurisdictions, rather than excluding interested board members from participating in a decision, an additional safeguard is provided by submitting such transactions to a shareholder vote. In some jurisdictions, the practice of having such issues decided by the majority of the minority has been adopted and the reviewer might want to more closely examine the effectiveness of such a mechanism in a jurisdiction.

Essential criteria

1) Does the legal framework and/or jurisprudence: (a) require board members and key executives to disclose on a timely basis to the board that they, directly or indirectly, have a material interest in a contract or other matter affecting the company; and (b) to the extent that there are exemptions from (a), are such exemptions discretionary and granted only by the majority of the minority shareholders, a regulatory authority or a court drawing on statutory provisions and/or jurisprudence?
2) Is the board responsible for effectively monitoring and managing the activities of board members and key executives who have an interest in a contract, transaction or other matters affecting the company?
3) Are there any remedies for non-disclosure of a material interest by board members or executives?

Principle II.G.: Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress. Abusive self-dealing should be prohibited.

Relevant cross references to assess Principle II.G.:

Principle I.B., sub-Principle II.F.1., sub-Principle II.F.2., sub-Principle II.H.1., sub-Principle IV.A.7., Principle V.A., Principle V.C., sub-Principle V.D.7.

Likely practices to be examined

The potential for abuse is higher where the legal system allows, and the market accepts, controlling shareholders to exercise a level of control which does not correspond to the level of risk that they assume as owners by exploiting legal devices to separate ownership from control, such as pyramid structures or multiple voting rights. The reviewer will need to be aware that abuse of minority shareholders can be carried out in various ways, including the extraction of direct benefits via high pay and bonuses for employed family members and associates, abusive related party transactions, systematic biases in business decisions and the special issuance of shares favouring the controlling shareholder.

Abuse of minority shareholders is most pronounced in jurisdictions where the legal and regulatory framework does not establish a clearly articulated duty of loyalty of board members and officers to the company and to all its shareholders as required by Principle V.A. or where safeguards to manage related party transactions are absent or present loopholes. In the absence of a clear duty of loyalty, redress might prove more difficult. A particular issue requiring investigation by a reviewer arises in some jurisdictions where groups of companies are prevalent and where the duty of loyalty of a board member might be ambiguous and even interpreted as to the group. The annotations clarify that "A key underlying principle for board members who are working within the structure of a group of companies is that even though a company might be controlled by another company, the duty of loyalty of a board member is related to the company and all of its shareholders and not to the controlling company of the group." In these cases, some jurisdictions have developed sets of rules to control negative effects, including by specifying that a transaction in favour of another group company must be offset by the receipt of a corresponding benefit from other companies of the group. Further, per the annotations, "Considering that some group structures may lead to disproportionate and opaque control, and the risks this may create with respect to the rights of non-controlling shareholders, some jurisdictions place limitations on certain structures of company groups such as cross-shareholdings." The experience with such arrangements will need to be carefully assessed.

Ex-ante provisions to protect minority shareholders that are relevant for the essential criteria include:

- pre-emptive rights in relation to share issues
- qualified majorities for certain shareholder decisions including majority-of-the-minority approval for transactions so that related shareholders can be treated differently from unrelated shareholders
- the ability of minority shareholders to convene a meeting of shareholders (e.g. an extraordinary meeting) is also a potentially important mechanism to protect minority shareholders
- cumulative voting for electing members of the board, which is considered relevant by some, but where this option is voluntary it has not been widely used by companies
- in some companies and jurisdictions, the appointment of several board members (or members of an audit committee or similar body) by the minority, but the practice is not widespread.

Ex-post means of redress (see also the list in Table 2) include:

- derivative and class action lawsuits under the company law framework
- enforcement/investigation by the regulatory authorities.

The annotations add that "Most regulators have established mechanisms to receive and investigate complaints from shareholders, and some have the possibility to support lawsuits through disclosure of relevant information (including whistleblowing mechanisms) and/or funding." The balance between *ex-ante* and *ex-post* protection will vary from one jurisdiction to another and the absence of one or the other does not necessarily mean that a reviewer should regard the Principle as less than fully implemented.

In forming an assessment for jurisdictions characterised by controlling shareholders, the reviewer will need to examine the evidence for abuse of minority shareholders and how effective the different enforcement mechanisms have been in practice. Collecting information from investors, market participants, judges of commercial disputes and a review of case law can inform the assessment. Lack of evidence of enforcement and/or barriers to effective enforcement include thresholds for shareholder action that can be easily manipulated, poor powers of discovery and/or high costs if a resort is made to litigation. The assessment will also need to be consistent with V.A. and V.D.7. which deal with the fiduciary duties of the board and with the control of related party transactions respectively. Weaknesses in the implementation of any of these associated principles will need to be reflected in the assessment of Principle II.G.

Abusive self-dealing covers another aspect of persons close to a company exploiting the relationship to the detriment of the company and investors but is usually more complex. As a consequence, self-dealing *per se* is often not prohibited (although some transactions such as material loans might be prohibited) but rather is subject to a set of safeguards provided in the legal framework and company arrangements of a different form from those associated with insider trading. To obtain a complete picture of what is a widespread problem, the reviewer needs to take a number of Principles into account. Principle II.F. deals with declarations of interest in a transaction, and sub-Principle V.D.7. advocates a major role for the board in controlling self-dealing. Principle II.G. complements the duty of the board with a more general protection of minority shareholders from abuse by controlling shareholders. Ethical standards adopted by companies often include principles to deal with self-dealing (Principle V.C.). An assessment as to whether Principle II.G. is implemented will therefore need to be consistent with a number of individual principles and involve a judgement about whether they constitute, as a whole, an effective safeguard for investors against abusive self-dealing.

Essential criteria

1) Does the corporate governance framework provide effective *ex-ante* mechanisms for minority shareholders to protect their rights?
2) Does the corporate governance framework provide for *ex-post* redress mechanisms that help ensure effective enforcement of shareholder protection against abusive self-dealing by insiders or controlling shareholders?

Principle II.H.: Markets for corporate control should be allowed to function in an efficient and transparent manner.

Principle II.H. is concerned with ensuring an efficient allocation of resources subject to procedures to ensure that other aspects of the Principles concerning shareholder rights are protected. An effective market for corporate control makes it possible for those who can use the corporate resources best to acquire control over them. However, such transactions can involve questions about the equal treatment of shareholders, particularly the treatment of minority shareholders, which is an important aspect of the Principles. Principle II.H. is also concerned with the control power exerted by insiders (e.g. entrenched management) which raises a number of corporate governance issues (e.g. increase agency costs).

As background, the reviewer will need to first look at the recent history in the market for corporate control. Hostile takeovers are the exception in many jurisdictions but mergers, agreed takeovers and sales of control blocks are more common. Different ownership structures are in part responsible for this disparity

so that a comparative lack of takeover activity should not be construed as a *prima facie* case for non-implementation of the Principle.

Sub-Principle II.H.1.: The rules and procedures governing the acquisition of corporate control in capital markets, 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.

Relevant cross references to assess sub-Principle II.H.1.:
Principle II.E., Principle II.F., Principle II.G., Principle III.G., Principle V.B.

Likely practices to be examined

The rules and procedures governing the acquisition of corporate control might vary considerably between companies in a jurisdiction depending on company bylaws, the structure of ownership and listing regulations. Some jurisdictions have take-over codes or laws specifying procedures quite closely, including the establishment of toeholds to support a take-over bid. They usually include provisions to protect minority shareholders by requiring bidders to offer to purchase shares at a particular price (i.e. mandatory tender offer rules) and there might also be thresholds at which minority shareholders can require the majority to buy their shares, and/or a threshold at which the outstanding shareholders can be squeezed out. The sub-Principle does not set an absolute standard for the nature of the rules and procedures, but the reviewer should be satisfied that arrangements are clearly articulated, disclosed and implemented so that the rights can be incorporated into the price of different classes of shares. The reviewer should therefore look at cases of *ad hoc* or unexpected actions by controlling shareholders and boards, which could have been to the detriment of other shareholders.

In the jurisdictions where control rights are concentrated, transfers of control typically occur through private sales. Such action could involve a related party transaction as when assets are sold to another company controlled by the same shareholder. The sub-Principle therefore advocates transparent prices and conditions to protect minority shareholders and the reviewer will need to examine how this is being achieved in practice. In some jurisdictions, emphasis is on the role of independent members of the board or an external opinion in assessing the fairness of the transaction. Redress mechanisms might also be available to shareholders in principle, but experience often shows that bringing cases to court may be costly and/or the process of discovery can be limiting. A special case involves privatisations when the government first makes an IPO to the public and then, at a later stage, sells a remaining control block to a group of investors. The framework regulating privatisations will in these cases often override the usual take-over rules such as mandatory tender offers. For the sub-Principle to be fully implemented, the reviewer should be satisfied that the initial IPO prospectus has made it clear to investors that they will not benefit from any control premium.

Some jurisdictions provide options for exit at a fair and reasonable market price to dissenting shareholders in case of major corporate restructurings including mergers and amalgamations. De-listing a company is another special aspect of the market in corporate control and might be particularly damaging to some shareholders and to stakeholders such as creditors. Laws and regulations covering de-listing vary greatly: in some jurisdictions it is a decision to be taken by a qualified majority of the shareholders, in others it is an issue for the board to decide. The capital market authority may also impose conditions such as specifying a maximum number of shareholders for a de-listing to be approved by the authority. It is essential that the corporate governance framework includes provisions to protect minority shareholders and to ensure that transactions occur at transparent prices and under fair conditions with criteria for their determination. Tender offers and squeeze-out provisions are areas to be examined by a reviewer as well

as any obligations on the board to obtain an independent opinion about the valuation. The assessment of both Principles II.G. and V.B. should also be examined for consistency.

Essential criteria

1) To prevent abusive acquisition of corporate control, are there requirements for timely disclosure to shareholders and the regulator of a substantial acquisition of shares, often in the form of thresholds, and are these effectively enforced by the capital market authority, financial market supervisor or by easy and timely access to courts by shareholders?
2) Is the corporate governance framework covering the market for corporate control (as well as the procedures to be followed in the event of de-listing) clearly articulated and does it ensure that shareholders of a particular class are treated in the same manner as controlling/majority shareholders in terms of the price they receive for their shares?
3) Does the corporate governance framework require that the plans and financing of a transaction are clearly known to both the shareholders of the offering company when it is a publicly listed company as well as to those of the target company? Are shareholders given sufficient time and information to make an informed decision in a manner that underpins price transparency and fair conditions in the market for corporate control?

Sub-Principle II.H.2.: Anti-takeover devices should not be used to shield management and the board from accountability.

Relevant cross references to assess sub-Principle II.H.2.:
Principle II.B., Principle II.C., Principle V.A., Principle V.E.

The annotations to sub-Principle II.H.2. note that in implementing any anti-takeover devices and in dealing with takeover proposals, the fiduciary duty of the board to shareholders and the company must remain paramount. The sub-Principle is thus closely related to Principle V.A. that specifies the fiduciary responsibilities of the board.

Likely practices to be examined

Sub-Principle II.H.2. is particularly important for jurisdictions and companies where shareholdings are dispersed so that the market for corporate control can be potentially restricted by a number of barriers to an investor gaining control. The challenge for the reviewer is to judge their ultimate impact since many techniques may never be used to shield management and the board from accountability, either because they are not permitted in a company's bylaws or because a company has already committed not to use them for this purpose. Some devices may be useful during negotiations of a takeover price, shifting the balance of bargaining power to the target company and its shareholders, but others might be used simply to protect and entrench management and the board. The term "board" refers to the members of the supervisory and management boards in jurisdictions with a two-tier board structure. It is therefore not possible to form a judgement based on the types of instruments that might be used. More direct evidence of management and board entrenchment might also be considered such as whether or not turnover of chief executives and boards is related to company performance. The views of market participants may also be important. Either way, such information must be interpreted in context.

In some cases, there are also breakthrough rules once a potential bidder reaches a certain level of ownership allowing them to set aside the anti-takeover measures, and in a number of jurisdictions there are also takeover codes or laws, stock exchange requirements, etc., which might regulate the use of various barriers. An assessment will have to therefore seek to determine first what is the actual or potential situation in a jurisdiction for corporate control, and then to determine the role of the barriers. A judgement

will also need to consider that companies often differ widely in a jurisdiction in their objectives and use of barriers.

The implementation status of other principles will need to be taken into account in forming a judgement. Clearly, the greater the direct powers of shareholders as specified in Principles II.B. and II.C., the greater the likelihood that restrictions will be used as bargaining devices rather than as barriers to the operation of a market for corporate control. Similarly, the stronger the fiduciary duty of the board, as specified in Principle V.A., and the ability of the board to exercise objective independent judgement on corporate affairs, as specified, Principle V.E., the greater the likelihood that a market in control will exist and that barriers will be used as negotiating instruments. There should be effective enforcement (by authorities or through not prohibitively expensive private action, either individually or collectively) and remedial systems. If the board can act without regard to the interests of shareholders or if the concept of duty to the company is very broad and frequently cited to reject offers, the jurisdiction should be noted as not having implemented the sub-Principle.

Essential criteria

1) Does the jurisdiction have a well-defined concept of the duty of loyalty owed by the company's board members and officers to the company and its shareholders which in the case law or jurisprudence of the jurisdiction extends to the consideration of a takeover proposal received by the company?
2) Does the corporate governance framework prohibit anti-takeover devices that effectively shield management from the functioning of the market for corporate control?
3) Do market participants judge that management and boards are generally subject to sufficient market pressure so as to be *de facto*, as well as *de jure*, accountable for their stewardship of companies?

Chapter III: Institutional investors, stock markets, and other intermediaries

Introduction

The overarching principle of Chapter III of the Principles states that "The corporate governance framework should provide sound incentives throughout the investment chain and provide for stock markets to function in a way that contributes to good corporate governance".

The annotations emphasise that the presence of intermediaries acting as independent decision makers influences the incentives and the ability to engage in corporate governance. The annotations also state that "The ability and interest of institutional investors and asset managers to engage in corporate governance vary widely. For some, engagement in corporate governance, including the exercise of voting rights, is a natural part of their business model. Others may offer their beneficiaries and clients a business model and investment strategy that does not include or motivate spending resources on active shareholder engagement. If shareholder engagement is not part of the institution's business model and investment strategy, mandatory requirements to engage, for example through voting, may or may not be effective and could potentially lead to a box-ticking approach". The annotations indicate that many jurisdictions have introduced codes on shareholder engagement ("stewardship codes") as a complementary governance tool with the aim of strengthening both institutional investor accountability and their role in holding company boards and management accountable.

Issues and assessment criteria

Principle III.A.: The corporate governance framework should facilitate and support institutional investors' engagement with their investee companies. Institutional investors acting in a fiduciary capacity should disclose their policies for corporate governance and voting with respect to their investments, including the procedures that they have in place for deciding on the use of their voting rights. Stewardship codes may offer a complementary mechanism to encourage such engagement.

Relevant cross references to assess Principle III.A.:

Sub-Principle II.C.2.

While this Principle does not require that institutional investors vote their shares, the annotations highlight that "[f]or institutions acting in a fiduciary capacity, such as pension funds, collective investment schemes and some activities of insurance companies, as well as asset managers, the right to vote could be considered part of the value of the investment being undertaken on behalf of their clients." This Principle therefore encourages the use of mechanisms that may support such participation and engagement, including calls for disclosure of how they exercise their ownership rights with due consideration to cost effectiveness.

Likely practices to be examined

The annotations state that "In some jurisdictions, the demand for disclosure of policies for corporate governance and voting to the market is quite detailed and includes requirements for explicit strategies regarding the circumstances in which the institution will intervene in a company, the approach it will use for such intervention, and how it will assess the effectiveness of the strategy. Disclosure of actual voting records is recognised as good practice, especially where an institution has a declared policy to vote. Disclosure is either to their clients (only with respect to the securities of each client) or, in the case of investment advisors to registered investment companies, to the market via public disclosure." Furthermore, some jurisdictions also provide more specific requirements or guidance regarding other forms of ownership engagement, such as monitoring investee companies and constructive engagement. This may take the form of regulatory requirements or soft law recommendations set out in stewardship codes to which institutional investors may voluntarily adhere or, in some jurisdictions, requirements to disclose their practices in relation to the code's recommendations.

Essential criteria

1) Does the legal and regulatory system, including court rulings, clearly recognise the duty of institutional investors acting in a fiduciary capacity to consider whether and under what conditions they should exercise the voting rights attached to the shares held on behalf of their clients?
2) Does the corporate governance framework require or encourage the disclosure of voting policies and, where an institution has a declared policy to vote, of actual voting records, and of the procedures in place to decide on the use of these rights? Where disclosure is required or encouraged, is the standard widely observed?

Principle III.B.: Votes should be cast by custodians or nominees in line with the directions of the beneficial owner of the shares.

Relevant cross references to assess Principle III.B.:

Sub-Principle II.A.4., Principle II.C., sub-Principle II.C.1.

Likely practices to be examined

The annotations state that “Custodian institutions holding securities as nominees for customers should not be permitted to cast the votes on those securities unless they have received specific instructions to do so. In some jurisdictions, listing requirements contain broad lists of items on which custodians may not vote without instruction, while leaving this possibility open for certain routine items. Rules should require that either investment advisors or custodian institutions provide shareholders with timely information concerning their options in the exercise of their voting rights. Shareholders may elect to vote by themselves or 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.”

The annotations state that “Holders of depository receipts should be provided with the same ultimate rights and practical opportunities to participate in corporate governance as are accorded to holders of the underlying shares. Where the direct holders of shares may use proxies, the depositary, trust office or equivalent body should therefore issue proxies on a timely basis to depository receipt holders. The depository receipt holders should be able to issue binding voting instructions with respect to the shares, which the depositary or trust office holds on their behalf.” In some jurisdictions, such rights are restricted to normal company issues such as electing boards, thereby excluding the right to vote on takeover offers and other extraordinary transactions. Where this is the case, the Principle should be assessed as partly implemented. It should be noted that the assessment is with respect to the jurisdiction under review and to the institutions domiciled therein. The fact that domestic shareholders may not be able to exercise such rights in another jurisdiction is outside the scope of the assessment.

Essential criteria

1) Does the legal framework or private contracts for the relationship between custodians, nominees and their clients guarantee:
    a) the rights of beneficial shareholders to direct the custodian or nominee as to how the shareholder’s vote should be cast
    b) that votes will be cast in accordance with any instructions provided by the beneficial shareholder
    c) that the custodian or nominee will not cast the votes on the securities unless they have received specific instructions to do so (except where listing requirements permit it for certain routine items).
2) Is compliance with the directions of shareholders widely observed (bearing in mind that trustees or other persons operating under a special legal mandate, such as bankruptcy receivers and estate executors, would not be covered by this criterion)?

Principle III.C.: Institutional investors acting in a fiduciary capacity should disclose how they manage material conflicts of interest that may affect the exercise of key ownership rights regarding their investments.

Likely practices to be examined

Institutional investors acting in a fiduciary capacity might be a subsidiary or an affiliate of another financial institution, and especially an integrated financial group. In these cases, they might be subject to conflicts of interest such as when, for example, a fiduciary votes its clients’ proxies in favour of a proposal that would benefit the business of its affiliate. A great deal will depend on the financial structure of a jurisdiction. Normal laws of fiduciary duty might not be strong enough in such situations or any breaches might be difficult to detect and effectively enforced. In part as a result, many jurisdictions have adopted regulations

requiring disclosure of how institutional investors manage material conflicts of interest, which may be industry-specific, such as with respect to pension or other investment funds. In some jurisdictions, industry codes or stewardship codes are used and call for the development and disclosure of policies to control conflicts of interest. These regulations and codes may call for disclosure of the policy to their clients together with the nature of the actions taken to implement the policy, and to make transparent their fee structures for asset management and other intermediary services. The reviewer will need to examine their practices in forming a judgement about the implementation of the Principle. To address such concerns, the annotations call for transparency of fee structures for asset management and other intermediary services.

Essential criteria

1) Does the corporate governance framework encourage or require institutional investors acting in a fiduciary capacity to develop a policy for dealing with conflicts of interest that may affect their decisions regarding the exercise of key ownership rights?
2) Does the framework encourage or require institutional investors acting in a fiduciary capacity to disclose conflict of interest policies and ensure transparency of their fee structures for asset management and other intermediary services?
3) Where disclosure is required or encouraged, is the standard widely observed?

Principle III.D.: The corporate governance framework should require that entities and professionals that provide analysis or advice relevant to decisions by investors, such as proxy advisors, analysts, brokers, ESG rating and data providers, credit rating agencies and index providers, where regulated, disclose and minimise conflicts of interest that might compromise the integrity of their analysis or advice. The methodologies used by ESG rating and data providers, credit rating agencies, index providers and proxy advisors should be transparent and publicly available.

Principle III.D. recognises the key role of the professions and activities that serve as conduits of analysis and advice to the market, while also acknowledging that in some jurisdictions certain categories of service providers may not be subject to direct regulation and supervision. These intermediaries, if they are operating free from conflicts of interest and with integrity, can play an important role in providing incentives for company boards to follow good corporate governance practices and underpin capital market integrity.

Likely practices to be examined

Concerns have arisen in a number of jurisdictions in response to evidence that conflicts of interest may arise for those providing analysis or advice and that this may affect their judgement. This could be the case when the provider of a service is also seeking to provide other services to the company in question, or where the provider has a direct material interest in the company or its competitors. The concern identifies a highly relevant dimension of the disclosure and transparency process that targets the professional standards of stock market research analysts, rating agencies, investment banks, etc.

The investment chain from ultimate owners to corporations not only involves multiple intermediary owners, it also includes a wide variety of professions that offer advice and services to intermediary owners. The annotations state that "Proxy advisors who offer recommendations to institutional investors on how to vote and sell services that help in the process of voting are among the most relevant from a direct corporate governance perspective. In some cases, proxy advisors also offer corporate governance related consulting services to corporations. Credit rating agencies rate companies according to their ability to meet their debt obligations and ESG rating providers rate companies according to various environmental, social and governance criteria. Analysts and brokers perform similar roles and face the same potential conflicts of

interest." The annotations state that "Considering the importance of – and sometimes dependence on – various services in corporate governance, the corporate governance framework should promote the integrity of regulated entities and professionals that provide analysis or advice relevant to decisions by investors, such as proxy advisors, analysts, brokers, ESG rating and data providers, credit rating agencies, and index providers." The annotations also describe that "Many jurisdictions have adopted regulations or voluntary codes of conduct or have encouraged the implementation of self-regulatory codes designed to mitigate such conflicts of interest or other risks related to integrity, and have provided for private and/or public monitoring arrangements."

The annotations also state that "These service providers, particularly ESG rating and index providers, can have significant impact on companies' governance and sustainability policies and practices given their rating methodologies and index inclusion criterion. Therefore, the methodologies used by regulated service providers that produce ratings, indices and data should be transparent and publicly available to clients and market participants."

Essential criteria

1) Does the corporate governance framework require or encourage those in the business of providing analysis or advice that is relevant to decisions by investors (such as proxy advisors, analysts, brokers, ESG rating and data providers, credit rating agencies and index providers, where regulated) to disclose conflicts of interest and how they are managed to minimise them?
2) Does the corporate governance framework require or encourage disclosure of the methodologies used by regulated service providers that produce ratings, indices and data for their analysis and advice relevant to decisions by investors? Whether required or encouraged, is the standard widely observed?

Principle III.E.: Insider trading and market manipulation should be prohibited and the applicable rules enforced.

Relevant cross references to assess Principle III.E.:
Principle IV.E., sub-Principle V.D.7.

Likely practices to be examined

As described in the annotations, insider trading entails manipulation of capital markets and is prohibited by securities regulations, company law and/or criminal law in most jurisdictions. Sometimes it is covered by market abuse regulation and law. Either way, the Principle calls for prohibition and the need for effective, proportionate and dissuasive sanctions for violations. In some jurisdictions, the definition of insider trading can be rather narrow so that the intent of the Principle might not be implemented. Indeed, in some jurisdictions, cases are quite rarely if ever prosecuted even though legislation has been on the books for quite some time. In forming a judgement, a reviewer should review the record of vigorous enforcement including prosecutions and successful prosecutions. Where there have been few or even no successful prosecutions, the reviewer should be inclined to judge that the Principle is only partly implemented, and the main cause identified.

The annotations indicate that the effectiveness of prohibition of insider trading and market manipulation depends on vigorous enforcement action. This in turn depends upon continuous monitoring and the use of effective quantitative analytical methods (e.g. by the stock exchange, the regulator) to detect cases of potential market abuse. The Methodology For Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation places quite specific standards on what should be required for legislation to be effective and should form a guide for the reviewer.[2] It should also be noted that the IOSCO Principles address a broader category of behaviours many of which are still within the spirit of the

G20/OECD Principles. The essential criteria draw on the IOSCO standard giving attention to the actual process of enforcement. Should all elements not be fulfilled, the jurisdiction should be assessed as not or only partly implementing the Principle, but attention should also be paid to the assessment of Principle IV.E. on ensuring equal and timely access to relevant information and sub-Principle V.D.7. on board monitoring and managing of conflicts of interest and misuse of corporate assets.

Essential criteria

1) Does the corporate governance framework prohibit improper insider trading and similar abusive conduct by insiders such as market manipulation? Is the definition of insider trading sufficiently broad and encompassing as to ensure that it cannot be easily evaded? Is there an effective monitoring and enforcement regime to deter and detect insider trading and similar abusive conduct and does the regime impose effective, proportionate and dissuasive sanctions for violators?
2) Does the corporate governance framework provide for continuous collection and analysis of trading data (e.g. by the stock exchange, the regulator) and timely reporting by insiders (including board members, senior officers and significant shareholders) of transactions (either direct or indirect) in listed companies' securities? Is there effective enforcement of these requirements?

Principle III.F.: For companies who are listed in a jurisdiction other than their jurisdiction of incorporation, the applicable corporate governance laws and regulations should be clearly disclosed. In the case of cross-listings, the criteria and procedure for recognising the listing requirements of the primary listing should be transparent and documented.

Likely practices to be examined

The annotations state that "It is increasingly common that companies are listed or traded at venues located in a different jurisdiction than the one where the company is incorporated. This may create uncertainty among investors about which corporate governance rules and regulations apply to that company. It may concern everything from procedures and locations for the annual shareholder meetings to minority rights". The annotations also describe that another important consequence of increased internationalisation and integration of stock markets is the prevalence of secondary listings of an already listed company on another stock exchange in a foreign jurisdiction, so called cross-listings.

The annotations state that companies should clearly disclose which jurisdiction's rules are applicable. The annotations also state that "When key corporate governance provisions fall under another jurisdiction than the jurisdiction of trading, the main differences should be noted." The annotations describe that "Companies with cross-listings are often subject to the regulations and authorities of the jurisdiction where they have their primary listing. In case of a secondary listing, exceptions from local listing rules are typically granted based on the recognition of the listing requirements and corporate governance regulations of the exchange where the company has its primary listing."

Essential criteria

1) Does the corporate governance framework require companies to clearly disclose which jurisdiction's rules are applicable? When key corporate governance provisions fall under another jurisdiction than the jurisdiction of trading, are the main differences noted?
2) Does the corporate governance framework require stock markets to clearly disclose the rules and procedures that apply to cross-listings and related exceptions from local corporate governance rules?

Principle III.G.: Stock markets should provide fair and efficient price discovery as a means to help promote effective corporate governance.

Relevant cross references to assess Principle III.G.:
Sub-Principle II.H.1., Principle III.E.

The quality of and access to market information including fair and efficient price discovery regarding their investments is important for shareholders to exercise their rights. Jurisdictions are looking at ways to improve their market structure to assure that their markets are fair, orderly, efficient and liquid, including by reviewing issues and in some cases adopting regulatory measures, regarding high-frequency trading, dark liquidity, fragmentation and volatility.

Likely practices to be examined

A fundamental aspect of this Principle is transparency, both pre- and post-trade. The Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation on the transparency of trading (Principle 35) underlines that market transparency is generally regarded as central to both the fairness and efficiency of a market, and in particular to its liquidity and quality of price formation. Principle 35 further states that "[t]he wide availability of information on bids and offers is a central factor in ensuring price discovery and in strengthening users' confidence that they will be able to trade at fair prices. This confidence should, in turn, increase the incentive of buyers and sellers to participate, facilitate liquidity, and stimulate competitive pricing."

This Principle should be assessed in conjunction with Principle III.E. for which the Methodology describes practices and criteria relevant for monitoring trading and using quantitative analytical methods to detect and prevent market manipulation, which are essential for fair and efficient price discovery. The definition of market manipulation should be broad enough not to be easily evaded and include transactions which may lead to misappropriation of client funds or property, and the misuse of client instructions for the intermediary's own trading purpose, i.e. "front running" or trading ahead of clients.

In evaluating whether stock markets provide fair and efficient price discovery, reviewers will need to consult with issuers, investors, and other market participants to get their views in this respect. An assessment should also take into account whether trading volume and market liquidity are sufficient to underpin fair and efficient price discovery. Sub-Principle II.H.1. on the rules and procedures governing the acquisition of corporate control calls for transactions to occur at transparent prices and under fair conditions. In cases where the trading volume is insufficient to determine a fair market price, regulators generally establish rules that may be used to help determine fair market value. However, to maintain consistency with IOSCO Principle 35, the essential criterion below focuses on transparency related to trading as a means of also promoting market liquidity.

Essential criteria

1) Has the IOSCO Principle 35 on the transparency of trading been fully implemented for equity markets in the jurisdiction?

Chapter IV: Disclosure and transparency

Introduction

The overarching principle for Chapter IV states that "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, sustainability, ownership, and governance of the company." The outcome advocated by the chapter is transparency which is central to (i) "shareholders ability to exercise their ownership rights on an informed basis"; (ii) market integrity; and (iii) the accountability of the company to its shareholders. The recommendations covered by the chapter specify the type of material information which should be disclosed, how and to whom this information should be communicated and the processes by which confidence in the quality of the information can be ensured. They reflect the responsibilities of the board which are covered in Chapter V.

Key to the operational nature of the chapter is the concept of materiality which is often incorporated into regulatory and legal systems; the annotations state that "Material information can be defined as information whose omission or misstatement can reasonably be expected to influence an investor's assessment of a company's value. This would typically include the value, timing and certainty of a company's future cash flows". Some jurisdictions define materiality as information that a reasonable investor would consider important in making an investment or voting decision. The annotations further state that "While corporate disclosure should focus on what is material to investors' decisions and may include an assessment of a company's value, it may also help improve public understanding of the structure and activities of companies, corporate policies and performance with respect to environmental, social and governance matters."

Issues and assessment criteria

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

The sub-Principles IV.A.1. to IV.A.10., which are important for an assessment of implementation of this Principle, specify in more detail elements that should be disclosed. The essential criteria refer to inadequate or misleading disclosure and call for remedial mechanisms. The latter might be difficult to implement since proof of loss by investors might be required. So long as there are at least effective and enforced disclosure standards, Principle IV.A. should be regarded as implemented even if remedial mechanisms for investors are either absent or seldom used.

Sub-Principle IV.A.1.: The financial and operating results of the company.

Relevant cross references to assess sub-Principle IV.A.1.:
Sub-Principle II.A.3., sub-Principle IV.A.8.

The annotations refer particularly to 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). The assessment should be consistent with that for sub-Principle II.A.3. which specifies access to relevant and material information as a basic shareholder right.

Likely practices to be examined

It has become increasingly common for periodic financial statements to be accompanied by a discussion/analysis by management and/or the board of operations and financial results. These are also increasingly future-oriented, encompassing sub-Principle IV.A.8. that covers potential risks.

Essential criteria

1) Does the corporate governance framework require publicly traded companies to disclose audited financial statements at least annually and do these include:

a) the balance sheet, profit and loss statement, cash flow statements and notes to financial statements clarifying the financial position of the company
b) a statement of changes in ownership equity
c) consolidated accounts where the company controls other companies?

2) Does the corporate governance framework require publicly traded companies to disclose at least annually a narrative discussion and analysis prepared by management and approved by the board of the company's financial condition and results of operation? Does such disclosure explain:
   a) management's assessment of the factors that affected the company's financial condition and results of operation over the period covered by the financial statements?
   b) known trends that are reasonably likely to have a material effect on the company's financial condition and results of operations in the future?

Sub-Principle IV.A.2.: Company objectives and sustainability-related information.

Relevant cross references to assess sub-Principle IV.A.2.:
Principle VI.A., sub-Principle VI.A.1., sub-Principle VI.A.2., sub-Principle VI.A.3., sub-Principle VI.A.4., sub-Principle VI.A.5.

The annotations state that in addition to their commercial objectives, companies should disclose material policies and performance metrics related to environmental and social matters, as elaborated on sustainability disclosure in Chapter VI. An assessment of this sub-Principle should take into account the related assessments of Principle VI.A. on sustainability-related disclosure, including sub-Principles VI.A.1. through VI.A.5.

Likely practices to be examined

In some jurisdictions, company law requires companies to state their objectives and not just in the most general form such as "pursuing commercial opportunities" which is the practice elsewhere. In others, the disclosure of specific commercial objectives is often regarded as essential to narrative reporting. Companies might also have a number of other objectives including environmental and philanthropic ones that may be important for investors to know. The sense of the sub-Principle is that companies should also disclose commercial and non-commercial objectives. The importance of such objectives is likely to vary widely between companies.

Essential criteria

1) Does the corporate governance framework require companies to disclose material information on their commercial and non-commercial objectives? Does the corporate governance framework require or encourage disclosing sustainability-related information (as elaborated in Principle VI.A. and sub-Principles VI.A.1. through VI.A.5.)?

Sub-Principle IV.A.3.: Capital structures, group structures and their control arrangements.

Relevant cross references to assess sub-Principle IV.A.3.:
Principle I.H., Principle II.D., and sub-Principle IV.A.4.

Likely practices to be examined

In many jurisdictions and in a large number of companies, there is a shareholder or group of shareholders in a controlling position that is not closely related to their equity ownership. The devices that a reviewer will need to investigate include pyramid structures, cross-shareholdings, shares with limited or multiple voting

rights, share caps, and investing some shares with rights to elect a majority of the board. The reviewer will, however, need to define the category of control instruments widely and ensure that they do not escape transparency requirements through regulatory loopholes.

An important case where the degree of control is often disproportionate to equity ownership concerns company groups and especially company groups involving several layers of subsidiaries, including across different sectors and jurisdictions. The annotations state "These structures may limit the ability of non-controlling shareholders of the parent and subsidiary companies to influence corporate policies and understand the risks involved and may allow controlling shareholders to extract private benefits from group companies."

Control disproportionate to the equity ownership is also exercised by shareholder agreements. The annotations state that they allow groups of shareholders "to act in concert so as to constitute an effective majority, or at least the largest single block of shareholders". In some jurisdictions it is necessary to disclose at least the governance aspects of the agreements (otherwise they may be legally void) and their duration is limited through regulation. If there are no effective (i.e. enforceable and enforced) provisions to disclose the governance aspects of such agreements, the sub-Principle should be assessed as not implemented. Responsibility to disclose can be with the company as soon as it becomes aware of a shareholder agreement or with the shareholder. Disclosure should also extend to informal agreements although enforcement might prove difficult. Shareholder agreements should not be confused with the right of shareholders to consult with each other, so long as by doing so they are not exercising or seeking to obtain control over the company (see Principle II.D.).

Cross shareholdings between companies are also common but are frequently limited by law (in order to protect the notion of company capital) to no more than a fixed percentage of capital (often ten per cent). Transparency is often poor in this area, although analysts and informed investors can often obtain the basic information from, *inter alia*, company registrars.

The disclosure of capital structures is so fundamental that the criterion does not foresee a voluntary disclosure requirement. Information about the difficult area of shareholder agreements is treated as in the more general form of the other criteria: the framework requires or encourages disclosure. A reviewer should not regard the sub-Principle as fully implemented unless companies generally disclose the required information at least annually in a comprehensive, easy to access and easy to use format so that interested persons can obtain a clear picture of the relevant capital structures. Disclosure obligations should also apply at the moment of material changes to the arrangements.

Essential criteria

1) Does the corporate governance framework require the disclosure on a continuing basis to shareholders of all capital structures, group structures and control arrangements that allow certain shareholders to exercise a degree of control disproportionate to their cash flow rights? These would include, *inter alia*, voting caps, multiple voting rights, golden shares, pyramid structures and any associated cross shareholdings. Does the corporate governance framework require the disclosure of shareholder agreements by either the company or the shareholders concerned covering, *inter alia*, lock-ins, selection of the chair and board members, block voting and right of first refusal?
2) Does the corporate governance framework require disclosures to be made in an easy to access and easy to use format so that interested persons can obtain a clear picture of the relevant capital structures, group structures and their arrangements? Is information updated on a timely basis if there is any change?

Sub-Principle IV.A.4.: Major share ownership, including beneficial owners, and voting rights.

Relevant cross references to assess sub-Principle IV.A.4.:
Principle I.H., sub-Principle IV.A.3.

The annotations state that "One of the basic rights of investors is to be informed about the ownership structure of the company and their rights vis-à-vis the rights of other owners. The right to such information should also extend to information about the structure of a group of companies and intra-group relations. Such disclosures should make transparent the objectives, nature and structure of the group".

Likely practices to be examined

The annotations state that "Disclosure of ownership data should be provided once certain thresholds of ownership are passed." The annotations also explain that "Such disclosure might include data on major shareholders and others that, directly or indirectly, may significantly influence or control the company through, for example, special voting rights, shareholder agreements, the ownership of controlling or large blocks of shares, the use of holding company structures involving layering of companies or significant cross shareholding relationships and cross guarantees. It is also required or considered good practice in some jurisdictions to disclose shareholdings of directors, including non-executives, and it is good practice that such disclosure is made on an ongoing basis."

The annotations state "For enforcement purposes in particular, and to identify potential conflicts of interest, related party transactions, insider trading and market manipulation, information about record ownership needs to be complemented with current information about beneficial ownership" (in some jurisdictions also termed ultimate owner). The annotations also state that "An increasing number of jurisdictions use a centralised national registry while others may require a company-level registry to facilitate access to up-to-date and accurate information on beneficial ownership. In cases where such registries are not available, information about the beneficial owners should be obtainable at least by regulatory and enforcement agencies and/or through the judicial process." The reviewer will need to examine whether such arrangements have in fact been effective. To this end, guidance issued by the Financial Action Task Force and IMF that advocates a multi-pronged approach to ensure availability of information, including the identification of the chain of ownership when involving complex ownership structures, can serve as reference points. If the arrangements appear effective, criterion 2 can be assessed as fully implemented.

Essential criteria

1) Does the corporate governance framework require disclosure about the recorded owner and holdings of persons who individually or collectively own a substantial (well below controlling) ownership interest in a company: (a) at least annually (e.g. annual report or shareholder meeting information circular); and (b) on a timely basis as soon as the ownership threshold requiring disclosure has been passed?
2) Is the disclosure requirement sufficiently broad to apply to complex ownership structures and arrangements, including those that may have been designed to conceal control?
3) Does the regulatory system ensure that current information about the beneficial owners should be obtainable at least by regulatory and enforcement agencies and/or through the judicial process? Is there evidence that such processes have proved effective? Where public disclosure of beneficial owners is required, do such disclosures give an accurate view of the ownership and control situation?

Sub-Principle IV.A.5.: Information about the composition of the board and its members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board.

Relevant cross references to assess sub-Principle IV.A.5.:
Sub-Principle IV.A.9., Principle V.E.

The annotations state “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. Information is also important to enable investors to assess the collective experience and qualifications of the board.”

Likely practices to be examined

With soft law such as codes and principles being particularly important in this area, the assessor will have to form a judgement about whether implementation of the sub-Principle by companies is widespread and about the effectiveness of market forces in encouraging disclosure. Experience in some jurisdictions suggests that only the most rudimentary of information about board members might be known before the meeting of shareholders in which case this sub-Principle should be assessed as not implemented. The annotations state that “For board members, standardised information should include their qualifications, share ownership in the company, membership of other boards and board committees, other executive positions, and whether they are considered by the board to be an independent member. This information may also refer to directors’ compliance with applicable independence criteria.” Criteria that may be relevant for assessing independence is described in greater detail under the annotations to Principle V.E.

Disclosure about the selection process and especially whether it was open to a broad field of candidates appears to be much less developed in many jurisdictions. The annotations state that “Such information should be provided in advance of any decision by the general shareholder’s meeting or on a continuing basis if the situation has changed materially.”

Even though it is not explicitly stated in the annotations, the intent of the Principles (for example sub-Principle V.D.7.) clearly covers the need for disclosure of market trading in the company’s shares and securities by board members and key executives, including their close family members and associates, but only where they have an economic interest in the transaction. This is relevant information to enable shareholders to assess the qualifications of board members, including their potential conflicts of interest and the impact this may have on their independence.

The annotations add that “Many jurisdictions require or recommend disclosure of the composition of boards, including on gender diversity. Such disclosure may also extend to other criteria such as age and other demographic characteristics, in addition to professional experience and expertise.”

Essential criteria:

1) Does the corporate governance framework require or encourage full and timely disclosure to shareholders (e.g. in annual reports, shareholder meeting circulars) about board members:
    a) qualifications and other board memberships and executive positions
    b) selection process
    c) whether they are regarded as independent, and the criteria used by the company for the assessment?
2) Does the corporate governance framework require board members and key executives to publicly disclose:

a) on a timely basis any transactions in the company's securities by them, and their close family members or associates if they have an economic interest in the transactions
b) on a periodic basis (e.g. in annual reports or shareholder meeting information circulars) the beneficial holdings of each board member and key executive (in each case taking into account beneficial ownership of the company's securities by the individual's close family members and associates only if they have an economic interest in those holdings)?

Sub-Principle IV.A.6.: Remuneration of members of the board and key executives.

Relevant cross references to assess sub-Principle IV.A.6.:
Sub-Principle II.C.5.

Likely practices to be examined

The annotations state that of particular interest to shareholders is the link between board and executive remuneration and the company's long-term performance, sustainability and resilience. The annotations state that companies are expected to disclose information on the remuneration of board members and key executives so that investors can assess the costs and benefits of remuneration plans and the contribution of incentive schemes, such as stock option schemes, to company performance. The annotations also point out that "Disclosure on an individual basis (including termination and retirement provisions) is increasingly regarded as good practice and is now required or recommended in most jurisdictions. Some of these jurisdictions call for remuneration of a certain number of the highest paid executives to be disclosed, while in others it is confined to specified positions." The annotations add that liability insurance policies and the use of sustainability indicators in remuneration may change managerial incentives and thus also warrant disclosure.

Essential criteria:

1) Does the corporate governance framework require or encourage full and timely disclosure about the remuneration of board members and key executives including:
   a) actual remuneration
   b) the link between remuneration and long-term company performance
   c) policy with respect to different forms of remuneration such as pension benefits and deferred remuneration?

Sub-Principle IV.A.7.: Related party transactions.

Relevant cross references to assess sub-Principle IV.A.7.:
Principle I.H., Principle II.F., sub-Principle II.F.1., sub-Principle II.F.2., sub-Principle IV.A.3., sub-Principle IV.A.4., Principle V.A.

The annotations emphasise that it is essential for companies to fully disclose all material related party transactions and the terms of such transactions to the market individually. The annotations add that "In case the jurisdiction does not define materiality, companies should be required to also disclose the policy/criteria adopted for determining material related party transactions. Related parties should at least include entities that control or are under common control with the company, significant shareholders including members of their families and key management personnel."

Likely practices to be examined

The disclosure of related party transactions is already a legal requirement and/or part of the accounting standards in most jurisdictions. The annotations state that special consideration should be given to whether the corporate governance framework properly identifies all related parties in jurisdictions with complex group structures involving publicly traded companies, reflecting the opaqueness that may be inherent in related party transactions within complicated group structures involving publicly traded companies and the possibility of circumventing disclosure requirements.

To make disclosure more informative, some jurisdictions distinguish related party transactions according to their materiality and conditions. Ongoing disclosure of material transactions is required, with a possible exception for recurrent transactions on "market terms", which can be disclosed only in periodic reports. To be effective, disclosure thresholds may need to be based mainly on quantitative criteria, but avoidance of disclosure through splitting of transactions with the same related party should not be permitted.

The annotations also state that related parties can include entities that control or are under common control with the company, significant shareholders including members of their families and key management personnel. Transactions involving the major shareholders (or their close family, relations etc.), either directly or indirectly, are potentially the most difficult type of transactions. The annotations describe that disclosure requirements include the nature of the relationship where control exists, and the nature, value and number of transactions with related parties, grouped as appropriate. The annotations also state that "Given the inherent opaqueness of many transactions, the obligation may need to be placed on the beneficiary to inform the board about the transaction, which in turn should disclose it to the market". Administrative penalties are often used to support the disclosure regime. This should not absolve the company from maintaining its own monitoring, which is an important task for the board.

Jurisdictions and companies differ widely with respect to how and when related party transactions need to be approved and this will affect the disclosure standard. The essential criteria thus need to be broad enough to cope with these essential differences.

However, related party transactions are frequently reported as one of the most serious breaches of good corporate governance around the world. It appears that the definition of a related party can be very loose and the criteria for being such a party easily avoided. The reviewer should investigate the definition and ensure that it is based on the concept of control (and not simply a defined position such as chief accountant) and is not easily evaded. Where it is not, the sub-Principle may either be classified as not observed or only partly observed. The reviewer should also be aware that in some jurisdictions, transactions with affiliated companies might not be regarded as a related party transaction (and so not disclosed) if so decided by a majority of shareholders and made a part of the company charter. While such provisions may be considered as a legitimate framework for transactions within company groups carried out regularly on market terms, the reviewer will need to investigate such possibilities and whether market participants such as investors consider that they are widely used to allow for abusive related party transactions. If the misuse of such loop-holes is reported as common, the sub-Principle should be assessed as not implemented.

Given the nature of related party transactions, enforcement might often prove difficult. This is particularly the case if the burden of proof rests with minority shareholders and there are only restricted powers of discovery. "Bright line" rules in the regulatory framework might assist private enforcement.

Essential criteria

1) Is the definition of "related party" sufficiently broad to capture the kinds of transactions that present a real risk of potential abuse, taking into account complex group structures involving publicly traded companies?
2) Does the corporate governance framework require timely, comprehensive and public disclosure of related party transactions? In this context, timely and comprehensive disclosure means:

a. in respect of transactions that should be subject to shareholder approval requirements in the jurisdiction, disclosure provided in sufficient time to enable minority shareholders to make an informed decision
b. in respect of proposed related party transactions that would likely have a material impact on the price or value of the company's shares but do not require shareholder approval, is disclosure provided in sufficient detail to enable minority shareholders to express concerns to management, authorities and the courts before the transaction is implemented
c. in respect of routine and/or less significant transactions, is there at least annual disclosure (e.g. in financial statements or annual reports).

3) Are there timely and effective mechanisms for enforcing disclosure standards, effective remedial mechanism for those who are harmed by inadequate disclosure, and is implementation of disclosure standards widespread?

Sub-Principle IV.A.8.: Foreseeable risk factors.

Relevant cross references to assess sub-Principle IV.A.8.:

Sub-Principle V.D.1., sub-Principle V.D.2., sub-Principle V.D.8.

The annotations address the needs of market participants for information on reasonably foreseeable material risks that may include: risks that are specific to the industry or the geographical areas in which the company operates; dependence on commodities and supply chains; financial market risks including interest rate or currency risk; risks related to derivatives and off-balance sheet transactions; business conduct risks; digital security risks; compliance risks and sustainability risks, notably climate-related risks.

Likely practices to be examined

It is increasingly common to require companies to complement financial reports with non-financial or narrative reporting that takes a more forward-looking perspective for discussing risks. What is regarded as a material risk, and any associated quantitative measures, will vary enormously from company to company, making hard and fast rules and regulations difficult to formulate and implement. This area is, therefore, often covered by codes and principles although many jurisdictions have legislation in place covering disclosure of certain risks, such as sustainability risks. An assessment will also need to take account of sub-Principles V.D.1., V.D.2. and V.D.8. that call on the board to establish a risk policy and to implement appropriate management systems. It is normally expected that companies should disclose general information about internal controls in place to manage risks, including assessment of their effectiveness. In view of the early stage of development of such reporting and the fact that its importance will depend in great measure on the types of companies operating in a jurisdiction, the reviewer should make a broad interpretation of implementation.

Essential criteria

1) Does the corporate governance framework require or encourage disclosure of reasonably foreseeable material risks and the procedures that have been established to manage such risks?

Sub-Principle IV.A.9.: Governance structures and policies, including the extent of compliance with national corporate governance codes or policies and the process by which they are implemented.

Relevant cross references to assess sub-Principle IV.A.9.:

Principle I.B., sub-Principle IV.A.5., sub-Principle V.D.3.

The annotations state that companies should report their corporate governance practices, and that such disclosure should be mandated as part of the regular reporting. The annotations continue that "Companies should implement corporate governance principles set, or endorsed, by the regulatory or listing authority with mandatory reporting on a "comply or explain" or similar basis. In most jurisdictions, a national report reviewing adherence to the corporate governance code by publicly traded companies is published as a good practice to support effective disclosure and implementation of "comply or explain" codes."

Likely practices to be examined

The annotations state that "Companies should clearly disclose the different roles and responsibilities of the CEO and/or chair and, where a single person combines both roles, the rationale for this arrangement. It is also good practice to disclose the articles of association, board charters and, where applicable, committee structures and charters." Many jurisdictions have now introduced supplementary codes or principles of corporate governance and almost all foresee some form of reporting about corporate governance practices. The codes and principles of corporate governance vary greatly and their status will also need to be considered by a reviewer following Principle I.B. A "comply or explain" requirement is not *per se* necessary for a positive assessment of the principle, although it should contribute to transparency about how the code or policy is implemented – both through reporting by companies themselves as well as via aggregate reports on compliance that may be issued by the supervisory authority or other designated institution. Other codes are on a purely voluntary basis so that the principle might not be regarded as implemented by a reviewer unless the jurisdiction has equivalent means of requiring or encouraging sufficient disclosure about corporate governance practices, such as through a corporate governance statement as further discussed below.

The information content of governance reports often varies widely between companies, some doing the bare minimum while others are very informative. Some codes apply to companies listed in the jurisdiction while others apply only to companies registered in the jurisdiction. The sub-Principle therefore calls for disclosure about which code or set of principles is followed by a company.

It would be consistent with the Principles to expect a corporate governance statement to include, *inter alia*, information about the ownership structure, the board structure, the qualifications of board members including who are regarded as independent, the procedures adopted by the board including the selection procedures for board members, and any code of corporate governance followed and how it has been implemented. It is also considered good practice to disclose committee structures, their mandate, scope, procedures, composition and charters, as applicable, along with company articles of association. Many of these elements might be included elsewhere in company reports or on the company website. To the extent they have been already addressed in other Principles (e.g. sub-Principles IV.A.5. on disclosure concerning board members and V.D.3. on board monitoring of governance practices), they are not repeated in the essential criteria for this sub-Principle. However, if the respective sub-Principles are assessed as not implemented, the assessment for this sub-Principle should be adjusted accordingly.

Essential criteria

1) Does the corporate governance framework require companies to publish, at least annually, a corporate governance report that, *inter alia*:
    a) describes the structure and operation of the board and its committees, including, where applicable, the rationale for combining the roles of CEO and chair
    b) describes how the company has implemented corporate governance practices recommended in any corporate governance code or policy that has been adopted by a relevant authority and applying to the company, or any code or policy that the company has adopted?

Sub-Principle IV.A.10.: Debt contracts, including the risk of non-compliance with covenants.

Relevant cross references to assess sub-Principle IV.A.10.:

Sub-Principle VI.D.6., sub-Principle VI.D.7.

The annotations state that "certain provisions in corporate bonds and other debt contracts may significantly limit the discretion of management and shareholders, such as covenants that restrict dividend payouts, require creditors' approval for the divestment of major assets, or penalise debtors if financial leverage exceeds a predetermined threshold. Moreover, under financial stress but before bankruptcy, companies may choose to negotiate a waiver of compliance with a covenant, when existing creditors may require changes in the business."

Likely practices to be examined

The annotations state that "the timely disclosure of material information on debt contracts, including the impact of material risks related to a covenant breach and the likelihood of their occurrence, in accordance with applicable standards, is necessary for investors to understand a company's business risks."

Essential criteria

1) Does the corporate governance framework require or encourage disclosure of material aspects in debt contracts, including the risk of non-compliance with covenants? Is there widespread implementation of the disclosure standard?

Principle IV.B.: Information should be prepared and disclosed in accordance with internationally recognised accounting and disclosure standards.

Relevant cross references to assess Principle IV.B.:

Sub-Principles IV.A.1. through IV.A.10., Principle VI.A., sub-Principle VI.A.2.

Principle IV.B. underpins a great deal of Principle IV.A.: high quality standards will often mandate disclosure about a number of the requirements specified above through IV.A.1. to IV.A.10. The annotations state that the application of high-quality standards is expected to significantly improve the ability of investors to monitor the company by providing increased relevance, reliability and comparability of reporting, and improved insight into company performance and risks.

Likely practices to be examined

The reviewer will need to examine whether domestic standards are in force and the circumstances under which internationally recognised accounting and disclosure standards are used by listed companies (e.g. optional, only for consolidated accounts). The annotations state that "High quality domestic standards can be achieved by making them consistent with one of the internationally recognised accounting standards". However, in practice, many jurisdictions allow exceptions to disclosure in accordance with internationally recognised standards, even though domestic ones may be "based on" or "compatible with" such standards. A key problem appears to be a lack of effective accounting and audit regulation but also a lack of effective institutions and high-powered incentives on the part of the private sector to enforce standards. This is a judgement generally shared by researchers although some see a greater role for private litigation in improving standards as being a priority.

For the assessment of IV.B., it is neither necessary nor possible for the reviewer to make a detailed assessment of the quality of the national accounting and disclosure standards. Other international

organisations are better placed to provide such an assessment and should be consulted. Nevertheless, a preliminary judgement is necessary and will need to be based on consultations with various market participants such as analysts, the accountancy and audit profession and the regulatory authorities. In some cases, judgements about equivalence might already have been made by bodies in other jurisdictions. Emphasis also needs to be given to processes: how well functioning is institutional oversight of the various standards, including self-regulation, and how effective is enforcement. Domestic standards (if in use or running in parallel with international standards) should be developed through open, independent, and public processes involving the private sector and other interested parties such as professional associations and independent experts. If international standards are in use, they should faithfully reflect the original standard meaning that adequate resources will need to be devoted to translation, including public processes to ensure faithful translation. Jurisdictions will, nevertheless, often retain a body charged with bringing international standards into local law.

Important from the perspective of public policy and the preservation of market integrity, is the effective enforcement of the financial reporting standards, whether domestic or international. The experience in some jurisdictions has been that public oversight of the implementation of reporting standards has been weak. In many jurisdictions, the first line of enforcement is the accounting and audit profession (gatekeepers), an arrangement which has not always worked according to expectation. It is important to ensure that a body, which could be the listing authority, the stock exchange, and/or the financial markets supervisor, has both the mission and resources to enforce the adoption of financial reporting standards. An additional means of enforcement, which needs to be considered by the reviewer, is the potential for investors to take action against the company should reports not meet the accepted standards in the jurisdiction.

With respect to non-financial reporting, referring not only to cross-referenced elements as considered applicable under sub-Principles IV.A.1. through VI.A.10., but also sustainability-related disclosure addressed in greater detail under Chapter VI, standards are often developed by the respective securities market regulator. However, for criterion 2 to be viewed as fully implemented, the reviewer should be satisfied that the standard setting body has the powers and the funding to carry out its duties.

Essential criteria

1) Does the corporate governance framework provide for an organisation(s) (either domestic and/or international) that is responsible for the development and interpretation of accounting standards? Are the standard setting and interpretation processes transparent? Do the standard-setting activities provide for effective consultation with the public? Where this organisation is domestic, are its standard setting and interpretations processes subject to the oversight of a body that acts in the public interest, that has an appropriate charter of responsibilities and powers, and that has adequate funding to carry out its oversight responsibilities? Are the accounting and disclosure standards regarded by a wide body of market participants and experts as high quality and consistent with internationally recognised standards?
2) Does the corporate governance framework provide for the development of disclosure standards by an organisation that either acts in the public interest (such as a securities regulator), or whose standard setting and interpretation processes are subject to the oversight of a body that acts in the public interest, has an appropriate charter of responsibilities and powers, and has adequate funding to carry out its oversight responsibilities? Are the organisation's standard setting and interpretation processes transparent? Do its standard-setting activities provide for effective consultation with the public?
3) Are mechanisms for enforcing disclosure and accounting standards and remedial mechanisms for those harmed by inadequate or misleading disclosure effective? Is implementation of these disclosure standards widespread?

Principle IV.C.: An annual external audit should be conducted by an independent, competent and qualified auditor in accordance with internationally recognised auditing, ethical and independence standards in order to provide reasonable assurance to the board and shareholders on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

Relevant cross references to assess Principle IV.C.:
Sub-Principle II.A.7., Principle IV.D., sub-Principle V.E.1.

The annotations indicate that the external auditor's opinion should certify that the financial statements represent fairly, in all material respects, the financial position and financial performance of a company. The annotations also state that the external auditor's report should include an acknowledgement that the financial statements are the responsibility of the company's management. The annotations further mention that the independence and ethical conduct of external auditors and their accountability to shareholders should be required and they should conduct the audit in the public interest. Furthermore, the annotations state the importance for implementation of the principle of IOSCO's Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence which states that, "standards of auditor independence should establish a framework of principles, supported by a combination of prohibitions, restrictions, other policies and procedures and disclosures, that addresses at least the following threats to independence: self-interest, self-review, advocacy, familiarity and intimidation."

Likely practices to be examined

In forming an assessment of the Principle, the assessor will need to examine institutions and processes that should ensure implementation of the Principle, rather than examining the Principle itself, such as whether external auditors are competent and independent. The reviewer will need to examine how audit standards are developed including the influence of any internationally recognised auditing, ethical and independence standards. Important sources of information and judgements for the assessor are provided by the accounting and audit ROSCs of the World Bank and by reports of other international organisations (e.g. IOSCO, International Forum of Independent Audit Regulators (IFIAR)).

A number of jurisdictions have put measures in place to better control potential conflicts of interest on the part of the external auditor. The annotation states that "Provision of non-audit services by the external auditor to a company can impair their independence and might involve them auditing their own work or present other threats to independence. To deal with such potential threats, some jurisdictions require the disclosure of payments to external auditors for non-audit services." This will require a clear definition of such services in the jurisdiction.

The annotations also state that "Examples of other provisions designed to promote external auditor independence include a ban or severe limitation on the nature of non-audit work which can be undertaken by an auditor for their audit client; periodic communications to the audit committee discussing the nature, timing and fees of the non-audit work (including the approval of such work); as well as relationships that may threaten auditor independence; mandatory rotation of the auditors; a fixed tenure for auditors; joint audits; a temporary ban on the employment of an ex-auditor by the audited company; and prohibiting auditors or their dependents from having a financial stake or management role in the companies they audit". The annotations continue that "Some jurisdictions take a more direct regulatory approach and limit the percentage of non-audit income that the auditor can receive from a particular client or limit the total percentage of auditor income that can come from one client". The reviewer will need to be aware of these practices and to what extent they seem well adjusted to local conditions.

The annotations state that "an issue that has arisen in some jurisdictions concerns the pressing need to ensure the competence of the audit profession. A registration process for individuals to confirm their

qualifications is considered good practice or required in some jurisdictions. This needs, however, to be supported by ongoing training and monitoring of work experience to ensure appropriate levels of professional competence and scepticism." With respect to quality assurance programmes, many jurisdictions have relied on self-regulation by the profession itself. However, in an increasing number of jurisdictions, public interest bodies have been established to oversee the task or to perform independent quality reviews.

In this regard, the annotations refer to the Core Principles of IFIAR, which call for the designation of an audit regulator that is independent from the profession, "and who, at a minimum, conducts recurring inspections of auditors undertaking audits of public interest entities, contributes to ensuring high quality audits that serve the public interest. In addition, regulators should have at their disposal a comprehensive and effective range of regulatory tools, including disciplinary measures/sanctions, independent investigatory powers vis-à-vis auditors under their jurisdictions, and the authority to communicate disciplinary measures/sanctions to the public to address any breaches of professional or statutory duties by an external auditor in a proportionate manner."

Board room procedures to oversee auditor competence and independence are taken up in sub-Principle V.E.1. A final assessment of the implementation of Principle IV.C. should assess board room practices. Such responsibilities are assigned to various bodies including the audit committee, which is separate from the board and sometimes includes representatives of minority shareholders, and in other cases by "statutory auditors" who are also non-voting members of the board. The reviewer will need to be familiar with the way each system actually functions and whether they are able to fulfil the requirements of the Principle and the essential criteria.

Essential criteria

1) Does the corporate governance framework:
    a) require companies to have their annual financial statements audited by an external auditor in accordance with a comprehensive body of auditing standards that are consistent with, or faithfully reflect, internationally recognised auditing, ethical and independence standards?
    b) require the external auditor to be independent of management, board members and controlling shareholders?
    c) require or encourage the process of selecting the external auditor to be overseen by a body such as the shareholders or a group of independent board members (e.g. an audit committee or equivalent), that is independent of management?
2) Does the corporate governance framework require auditors of listed companies to be licensed and does the framework for licensing of such auditors:
    a) require auditors to meet specified qualification and competency criteria before being licensed and continuing professional education requirements to maintain specified standards of professional competency?
    b) provide for withdrawal of authorisation to audit listed companies if specified qualifications and competency criteria are not maintained or there is non-compliance with ethical standards or audit control standards?
3) Does the corporate governance framework provide for an organisation to enforce audit standards (i.e. a quality assurance programme) that:
    a) is independent of (or subject to the oversight of a body that is independent of) the audit profession?
    b) has an appropriate membership, an adequate charter of responsibilities and powers, and adequate funding?

  c) employs processes for its public interest activities that are transparent and provide for public consultation with respect to the development of its procedures and principal operational policies?

4) Does the corporate governance framework provide for an organisation, domestic or international, that is responsible for developing and interpreting audit standards, as well as standards for the ethical behaviour of auditors? Where the institution is domestic:
   a) is it independent of (or subject to the oversight of a body that is independent of) the audit profession?
   b) does it have an appropriate membership, an adequate charter of responsibilities and powers and adequate funding?
   c) does it employ robust due processes for its public interest activities that are transparent and provide for public consultation with respect to the development of its standards?
5) Does the corporate governance framework require or encourage the board, audit committee or equivalent body to report to shareholders on:
   a) the actions it has taken and the bases upon which it has concluded that the auditor was independent and qualified?
   b) the value of any non-audit work undertaken for the company by the external auditor?
6) Where the audit standard is required, are there effective mechanisms for and evidence of their enforcement?

Principle IV.D.: External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit in the public interest.

Relevant cross references to assess Principle IV.D.:

Sub-Principle II.A.7., Principle IV.C.

The key outcome advocated by this Principle is that the external auditor understands that they are not responsible to the management (with whom they often have day-to-day collegial contact) but to the company (in the form of the board) and to the shareholders. This is independent from whether the requirements of an external audit are specified in either company or securities laws.

Likely practices to be examined

The annotations state that “The practice that external auditors are recommended by an independent audit committee of the board or an equivalent body and are elected, appointed or approved either by that committee/body or by the shareholders’ meeting directly can be regarded as good practice since it clarifies that the external auditor should be accountable to the shareholders. […] This practice, however, should not be seen as precluding other bodies such as the audit committee from making such appointments.”

A key issue concerns liability of external auditors for professional care in the conduct of the audit. There are many national approaches, depending in part on the size of the market for auditors and what is actually expected of the audit so that it is not possible to make broad generalisations that can be incorporated in the essential criteria for assessing the implementation of the Principle.

Essential criteria

1) Does the corporate governance framework clearly provide that external auditors are accountable to the company’s shareholders in respect to the performance of their audit functions?

2) Does the corporate governance framework provide for proportionate, effective and dissuasive sanctions, penalties and/or liabilities for external auditors who fail to perform their audit functions to the company with due professional care?

Principle IV.E.: Channels for disseminating information should provide for equal, timely and cost-efficient access to relevant information by users.

Relevant cross references to assess Principle IV.E.:
Sub-*Principle II.A.3., Principle III.E.*

Likely practices to be examined

The assessment of Principle IV.E. should also be consistent with that for sub-Principle II.A.3. which defines as a basic shareholder right the receipt of relevant and material information on a timely and regular basis. Of equal if not more importance, the Principle specifies equal access to material information. It thereby addresses one of the major channels for insider trading and the abuse of minority shareholders: selective access to market sensitive information by some shareholders or parties. Conclusions with respect to Principle III.E. on insider trading and market manipulation are therefore also relevant for forming a judgement as to the implementation of this Principle.

With respect to equality, many jurisdictions have quite specific regulations concerning how and under what conditions market sensitive information can be passed to shareholders and investors. This is crucial for market integrity and for the equal treatment of shareholders. Exceptions with respect to the prohibition on selective disclosure are often made for an issuer's communications with the press, and in the ordinary course of business communications with customers and suppliers. Without such exceptions, the regulatory system could prove unenforceable and inefficient. Enforcement can, however, be a problem with regulatory institutions sometimes lacking either the means of discovery or the incentive to allocate scarce resources to this aspect of regulatory enforcement. Private enforcement action might also be difficult given the need often to establish proof.

The annotations state that "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 jurisdictions by electronic filing and data retrieval systems. Jurisdictions should move to the next stage by integrating different sources of company information, including shareholder filings. Easily accessible and user-friendly company websites also provide the opportunity for improving information dissemination, and most jurisdictions now require or recommend companies to have a website that provides relevant and significant information about the company itself."

The annotations also state that provisions for ongoing disclosure which includes periodic disclosure and continuous or current disclosure which must be provided on an *ad hoc* basis should be required. With respect to continuous/current disclosure, good practice is to call for "immediate" disclosure of material developments, whether this means "as soon as possible" or is defined as a prescribed maximum number of specified days". In some cases, the reviewer might find that the materiality test is applied in an arbitrary manner that leads to excessive regulatory intervention. The IOSCO Principles for Ongoing Disclosure and Material Development Reporting by Listed Entities set forth common principles of ongoing disclosure and material developments reporting for listed companies. In addition, the IOSCO Principles for Periodic Disclosure by Listed Entities set guidance for the periodic reports of companies that have securities listed or admitted to trading on a regulated market in which retail investors participate.

Essential criteria

1) Does the corporate governance framework prevent selective disclosure by companies, board members, and other insiders of material non-public information except for clearly defined exceptions? Is there widespread compliance with the standard?
2) Does the corporate governance framework require listed companies to comply with an ongoing disclosure obligation to make timely disclosure on a non-selective basis of all information that would be material to an investor's investment decision? Is there widespread implementation of such disclosure standards?
3) Does the corporate governance framework require or encourage companies to make all information identified by the Principles easily accessible by investors and potential investors at no more than a minimal cost, including through website disclosures?

Chapter V: The responsibilities of the board

Introduction

The overarching principle for Chapter V states that "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." The outcome advocated is that the board is chiefly responsible for monitoring managerial performance and achieving an adequate rate of return for shareholders, while preventing conflicts of interest and balancing competing demands on the corporation. The board is not only accountable to the company and its shareholders but also has a duty to act in their best interests.

The principle is sufficiently general to apply to whatever board structure is authorised in each jurisdiction. In a two-tier board system this is typically the "supervisory board", composed of non-executive board members, while in unitary systems there are also typically executives on the board. In some jurisdictions, there is an additional statutory body for audit purposes. Moreover, assessments of all principles in this chapter should take into consideration how they may best be applied within the different types of board structures used in each jurisdiction. In two-tier systems, recommendations concerning the board are generally assigned to the supervisory board unless otherwise stated, while references to management and key executives may be considered to include members of the management board (but should not be construed to exclude other key executives who may not necessarily serve on the management board).

This chapter represents a particularly difficult challenge for a reviewer to form a judgement about implementation of the Principles. Even where jurisdictions explicitly articulate the responsibilities of the board, the law and associated regulation is incomplete, and in many respects the board is left to establish its own modalities. In some jurisdictions, company law and other regulations are even more general, leaving essential details to be established by the company itself. As a result, the actual structure and operation of boards in any given jurisdiction is likely to vary widely between companies and in some cases, the board might hardly function at all despite a clear legal framework. The reviewer is therefore in the difficult situation of having to judge what is the predominant behaviour or practice in determining the implementation status of the Principle.

An important guide to actual board behaviour, and the implementation status of the principles in this chapter, is provided by the judgements formed about certain principles in other chapters, notably about the quality of shareholders rights and the authority of shareholder meetings in chapter II and disclosure and transparency in Chapter IV. Favourable assessments about shareholder rights and transparency

should be seen by the reviewer more in the way of a necessary though not sufficient condition for implementation of the principles in this chapter.

Issues and assessment criteria

Principle V.A.: Board members should act on a fully informed basis, in good faith, with due diligence and care and in the best interests of the company and its shareholders, taking into account the interests of stakeholders.

Relevant cross references to assess Principle V.A.:

Sub-Principle II.F.2., Principle II.G., Principle V.D, Principle V.E., Principle V.F., Principle VI.D.

The outcome sought by the Principle is a board which is informed and objective in its oversight of management. A number of the other principles, cited as cross-references above, are intended to ensure that this Principle is implemented as effectively as possible. In this regard, an assessment of Principle V.D. and its sub-Principles will provide a sense of the practical application of Principle V.A. in terms of more specific key board functions.

Board members should also take into account, among other things, the interests of stakeholders, when making business decisions in the interest of the company's long-term success and performance and in the interest of its shareholders.

Likely practices to be examined

The Principle focuses on the fiduciary duties of board members: the duty of care and the duty of loyalty. With respect to the former, in some jurisdictions a standard of reference is the behaviour that a reasonably prudent person would exercise in similar circumstances. Good practice takes acting on a fully informed basis to mean that board members should be satisfied that key corporate information and compliance systems are fundamentally sound, which underpins the key monitoring role of the board advocated by the Principles. In many jurisdictions this meaning is already considered an element of the duty of care, while in others it is required by securities regulation, accounting standards etc. Information and compliance systems are explicitly stated as a board responsibility in sub-Principle V.D.8. Principle V.F. further underlines the importance of board member access to timely, accurate and relevant information in order to effectively fulfil its duty of care.

The duty of loyalty is important, since it underpins effective implementation of other principles relating to the equitable treatment of shareholders (e.g. Principle II.G.), monitoring and managing of related party transactions (sub-Principle II.F.2.) and the establishment of remuneration policy for key executives and board members (sub-Principle V.D.5.). It is also a key principle for board members who are working within the structure of a group of companies: even though a company might be controlled by another company, the board member's duty of loyalty should be to the company and all its shareholders and not to the controlling company of the group.

The implementation status of Principle V.A. is unobservable by those outside the boardroom, so the reviewer will need to monitor the "inputs". The first input to check is whether the jurisdiction defines the duty of care and duty of loyalty as key aspects of board members' fiduciary duties in their laws, regulation, jurisprudence, and practices. This may not be true in many jurisdictions even though there might be a tradition of using case law inspired by another jurisdiction. However, the laws and practice in a jurisdiction may well be less demanding in defining duties than the Principles which are more 'aspirational' in character. In these cases, the reviewer should be inclined to a judgement of either 'broadly implemented' or 'partly implemented' if the duties are particularly vague or untested.

The following three issues should be considered with regards to implementation of the duties of care and of loyalty that an assessment will need to address. First, enforcement via either class actions or derivative suits is often difficult, and in some cases depends on a prior investigation by a regulatory body. Moreover, procedural rules can be often very restrictive as, for example, with respect to proving that a related party transaction is abusive or prejudicial (the discovery issue and access to information). Indeed, in many cases the reviewer might find no history of enforcement actions, making a judgement difficult. However, the widespread use of board member liability insurance can be taken by the reviewer as an indication that there is at least some threat of enforcement action so that the Principle might be at least partly implemented. In addition, considering the rarity of specific enforcement cases in many jurisdictions, if the perception among active and informed market participants is that board members widely respect and follow clearly defined board duties of loyalty and care, the Principle may still be considered broadly or fully implemented. Many of these issues are related to Principle II.G. as referenced above, so there should be some consistency between the two assessments.

Second, even where cases can be brought, there is the question of the appropriate level of sanctions. High nominal liability with a low real probability of conviction might be optimal from a theoretical perspective but may also be the result of chance rather than purposeful design. To understand actual board member liability, comparative studies could assist in forming an assessment. When examining enforcement, looking at reputation damage might also be important to consider. However, in some jurisdictions with concentrated ownership, it appears that reputation may be less important. Reputation is likely to matter more where there is a broader shareholder input to board elections and also a deeper pool of companies offering employment opportunities.

Third, board members' duty of loyalty to their specific company in company groups could be significantly weakened if they are also obliged to follow group strategies. Unless there are compensating mechanisms, the Principle should be assessed as either not implemented or as only partly implemented. The existence of controlling owners could further confuse to whom the duty of loyalty is due. This issue has also been taken up by the essential criteria for Principle II.G. for consistency in the assessments.

The implementation of Principle V.A. could include, amongst other approaches, any requirement for independent board members and the role of shareholders in electing board members. The former is taken up in Principle V.E. on the exercise of independent judgement. A great deal will depend on how board member independence is implemented. There are numerous cases of definitions being subverted where board members come from related companies, as the law only specified, they could not come from subsidiaries. Where Principle V.E. is assessed as less than fully implemented, the assessment of Principle V.A. should not receive a more favourable rating.

Some jurisdictions require the board to consider the interests of stakeholders, with case law and company law specifying generally what this might mean in practice. For example, in some jurisdictions the board can reject a takeover offer, citing the broader interest of stakeholders, although sometimes this can be used as an excuse to entrench management. Codes and principles in some jurisdictions are used to set aspirational standards and can be influential in this area, often closely follow the wording of this Principle. However, minimum standards for the treatment of stakeholders are also often mandated through laws governing the protection of creditors, regulations concerning mass and individual dismissals and changes to labour contracts, to name a few examples (see Principle VI.D.). In some jurisdictions, reference to board consideration of stakeholder interests may not be explicitly made in the legal framework but may be considered nevertheless relevant for board members to make an informed decision to exercise their fiduciary duties in the interests of the company and its shareholders. Given the inherent uncertainty with this aspirational Principle, it is best for the reviewer to form a broadly-based judgement.

Essential criteria

1) Does the corporate governance framework define the fiduciary duties of board members? Does the definition provide a well-defined concept of the duty of loyalty and duty of care owed by the company's board members and officers to the company and shareholders?
2) Are there effective enforcement (by authorities or through widely accessible private action, either individually or collectively) and remedial systems? In jurisdictions where enforcement cases are rare, are board members nevertheless considered to widely follow well-defined duties of loyalty and care?
3) Where the board's duty of loyalty is loosely defined and can extend to other companies in a group, are there clear and effective safeguards to protect the interests of the specific company and its shareholders?
4) Does the corporate governance framework require or encourage boards to take into account the interests of stakeholders, either explicitly or indirectly through related fiduciary duties?

Sub-Principle V.A.1.: Board members should be protected against litigation if a decision was made in good faith with due diligence.

The annotations state that protecting board members and management from litigation for diligent, informed, and conflict-free business decisions encourages them to take risks that could benefit the company, even if these decisions have short-term costs or uncertain long-term impacts, as long as they reasonably expect the decision to contribute to the company's long-term success.

Likely practices to be examined

Sub-Principle V.A.1. aims to assess whether in the jurisdiction there are safe harbours, such as the business judgement rule, for courts to determine corporate liability and allow companies and their directors to have the necessary discretion to take business decisions and assume risks. With the complexity of risks boards are required to manage, for example sustainability and digital risks, the relevance and applicability of such a safe harbour comes under test.

Such safe harbours are, at times, specifically included in a legal framework through a provision and sometimes the result of case law. In both cases, courts have an important role in interpreting such safe harbours for judicial review. The assessor should therefore check the framework for the existence of such safe harbours and also examine what is, in practice, the standard of review for board members' business decisions, looking at how such safe harbours are framed and interpreted in practice by courts. Therefore, an assessor may analyse information on what must be proved by plaintiffs to overcome the presumption that the safe harbour applies to directors; the interpretation of courts; and the role of enforcement authorities and courts in reviewing business decisions.

Essential criteria

1) Does the legal framework and/or case law provide for a safe harbour aimed at protecting directors against litigation when business decisions were adopted diligently, with procedural due care, on a duly informed basis and without any conflicts of interest?

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

Relevant cross references to assess Principle V.B.:

Principle II.E., Principle II.G., Principle V.A.

This Principle complements Chapter II and expands on Principle II.E., which states that all shareholders of the same class should be treated equally, and on Principle II.G. on the protection of minority shareholders. It advocates that board members perform their duties impartially for all shareholders, regardless of who elected them (e.g. controlling or minority shareholders), aligning with Principle V.A. on the duty of loyalty and care.

Likely practices to be examined

In practice, individual board members may feel that they are representatives of particular constituencies, in particular controlling shareholders can often select a majority or all of the board members. Minority shareholders with significant shareholdings may also elect a specific director, and some jurisdictions that provide for election of employee board members by employees. Although these powers are legitimate, the Principle requires that upon appointment, the board members accept their duty of loyalty to all shareholders. The assessment status of Principle II.G. should have a large bearing on the assessment of Principle V.B.

With respect to enforcement, there may not be a well-established history for the reviewer to form a judgement about whether it is effective. The widespread use of board member liability insurance may be a useful indicator in circumstances where the threat of action is considered to be a real possibility. Where the duty is clearly specified in the law or by standards but there is limited history of enforcement although the threat is credible, the Principle could be judged as broadly implemented. Where the duty is not clearly specified but there is some threat of action, it should be considered as partly implemented with a further note on the nature of the weakness, etc.

Essential criteria

1) Are board members required or encouraged to take into account the possibility that board decisions may affect different shareholder groups differently and to refrain from acting in a way that is oppressive or unfairly prejudicial to any group of shareholders?

Principle V.C.: The board should apply high ethical standards.

Relevant cross references to assess Principle V.C.:

Principle V.A., sub-Principle V.D.7., sub-Principle V.D.8.

The annotations clarify that the board is responsible for setting the “tone from the top” through its actions. In considering the board’s effectiveness in establishing and applying high ethical standards, the reviewer’s assessments of Principle V.A. on the exercise of board duties and sub-Principles V.D.7. and V.D.8. on the monitoring of conflicts of interest and the integrity of the corporation’s accounting and reporting systems for disclosure and appropriate internal control systems will also be relevant. An ethical framework should go beyond compliance with the law, which should be a fundamental requirement. Since it is difficult to assess implementation of the Principle from outside the boardroom, evaluation should focus on institutional practices and processes.

Likely practices to be examined

To make their ethical standards clear and operational, many companies have found it useful to develop company-wide codes of conduct, setting the framework for the exercise of judgement in dealing with varying and often conflicting constituencies, and to communicate them throughout the company. A general description of the code in place should normally be made available by the company, either independently or as part of its corporate governance statement. This may also include a commitment by the company (including its subsidiaries) to comply with the OECD Guidelines for Multinational Enterprises and

associated due diligence standards (OECD, 2023[2]). However, the existence of such codes or commitments is neither a necessary nor sufficient condition for implementing the Principle. Similarly, jurisdictions are increasingly demanding that boards oversee the lobbying, finance and tax planning strategies that management is allowed to conduct. This may discourage practices that involve the pursuit of aggressive tax planning schemes, which do not contribute to the long-term interests of the company and its shareholders, and that can cause legal and reputational risks.

Essential criteria

1) Does the corporate governance framework require or encourage companies to develop, under the board's supervision, a code of ethical behaviour covering, *inter alia*, compliance with the law and professional standards?
2) Does the framework set clear limits on the pursuit of private interests by employees and communicate them throughout the company?
3) Do the boards report regularly on compliance with the code by board members and employees, and the implementation actions taken by the company?

Principle V.D.: The board should fulfil certain key functions:

Relevant cross references to assess Principle V.D.:

Principle IV., Principle V.A.

Principle V.D. specifies the key functions of the board, giving content to the more practical application of Principle V.A. The application of these duties is also detailed in Chapter IV on disclosure and transparency. If companies fail to fulfil these disclosure recommendations, reviewers may have grounds to conclude that the sub-Principles of Principle V.D., and thus the Principle itself, are not fully implemented.

Sub-Principle V.D.1.: Reviewing and guiding corporate strategy, major plans of action, annual budgets and business plans; setting performance objectives; monitoring implementation and corporate performance; and overseeing major capital expenditures, acquisitions and divestitures.

Relevant cross references to assess sub-Principle V.D.1.:

Principle V.A.

This sub-Principle specifies the key elements that are required to fulfil Principle V.A. and underlines that the purpose of the board is not to run the company on a day-to-day basis but to oversee management.

Likely practices to be examined

The explicit duties of a board may be specified in company law or be reflected in unwritten standards developed through jurisprudence, corporate governance codes or similar means. The focus should be on the structure and processes for carrying out board duties, although they vary across companies, depending on the size and industry or allocation of responsibilities between the supervisory and management boards in two-tier systems. To ensure transparency, some jurisdictions recommend that board duties are included in a board charter, the articles of association or the corporate bylaws.

In practice, boards have often not played a central and strategic role in a number of jurisdictions and companies. As in other principles, the essential criteria should assess whether there is "widespread implementation of the principle". This is particularly difficult for the reviewer to judge. In forming a

judgement, a reviewer should examine recent corporate scandals which have in many cases led to revelations that the board has not in fact conducted due diligence about significant expenditures and acquisitions and/or has only had the most general notion of the desired risk profile for the company. Such indicators would need to be supported by more general observations from the business community about what might be common practice in a jurisdiction and what is widely regarded as good practice. One such check might be to examine the nature of disclosure to investors about board processes leading to major acquisitions, capital expenditures and divestitures. Where absent or not explicit, it might indicate that the Principle is not in practice implemented. The reviewer will need to make an assessment based on discussions with, *inter alia*, board members, regulators, investors and other professional bodies about actual board practices.

Assessing enforcement is difficult. In some jurisdictions there may be recourse against the board if it fails to fulfil these duties (duty of care) but as noted above under Principle V.A., in practice such dereliction of duties might be hard to prove. More important might be the ability to remove boards that are not performing but in practice this will depend both on effective shareholder rights and on the concentration of ownership. The reviewer should base a judgement on the level of actual threat of enforcement even though there might be little sign of active enforcement in the past.

Essential criteria

1) Does the corporate governance framework clearly specify the key functions of the board to include the specific requirements of the Principle? Are there indications that, on the whole, boards play a central and strategic role in the jurisdiction?

Sub-Principle V.D.2.: Reviewing and assessing risk management policies and procedures.

Relevant cross references to assess sub-Principle V.D.2.:

Sub-Principle V.E.2.

The annotations stress the board's role in defining risk appetite, overseeing risk management, and aligning it with strategy. It should ensure that material sustainability matters are considered and address significant external risks which may include health crises, supply chain disruptions, geopolitical tensions, digital security and tax risk management.

Likely practices to be examined

Practices to consider in assessing this sub-Principle would be whether the company has in place *ex-ante* (to foster resilience in the event of a crisis), and ex-post (crisis management processes in case of an unexpected event) mechanisms. While the board may be assigned ultimate responsibility to oversee and decide on risk management matters, most jurisdictions have regulatory requirements or recommendations that the board be supported in the function of risk oversight by the audit committee, or the establishment of a separate risk committee. It may be valuable to have a separate risk committee, distinct from the audit committee, with a chair who is an independent director. In terms of practices, it may be challenging for the reviewer to assess actual risk management company-level policies and procedures, although a general indication of reported policies may be obtained if the jurisdiction has an aggregate corporate governance report on compliance with relevant code recommendations related to this topic. An assessment of sub-Principle V.E.2. on board committees is also relevant to this sub-Principle.

In forming a judgement, the reviewer could check studies and surveys to examine the extent to which boards and assigned board committees effectively review and evaluate risk management policies and procedures. In the absence of such surveys, an assessment would need to be supported by more general

observations from the business community about what might be common practice in a jurisdiction and what is widely regarded as good practice.

Essential criteria

1) Does the corporate governance framework require or encourage the board to ensure having adequate processes within their risk management frameworks to deal with significant external company-relevant risks, including the extent to which they may rely upon assigned board committees to support their assessment and management of company risks?

Sub-Principle V.D.3.: Monitoring the effectiveness of the company's governance practices and making changes as needed.

Relevant cross references to assess sub-Principle V.D.3.:

Sub-Principle IV.A.9., Principle V.A., sub-Principle V.E.4.

This sub-Principle, linked to sub-Principle IV.A.9. on disclosure of governance structures and policies, calls for the board to monitor their effectiveness, including in light of material changes to the company. It mirrors Principle V.A.'s duty of care, emphasising informed decision-making by board members. Boards should ensure effective governance by reviewing internal structures, ensuring they support the board's monitoring role as advocated by the Principles.

Likely practices to be examined

Monitoring of the company's governance by the board includes regularly reviewing the internal structure of the company to ensure that there are clear lines of accountability for management throughout the organisation. This sub-Principle is complemented by sub-Principle V.E.4., which states that "Boards should regularly carry out evaluations to appraise their performance and assess whether they possess the right mix of background and competences, including with respect to gender and other forms of diversity." As noted under sub-Principle IV.A.9., many companies now report corporate governance practices, but the reviewer in this case should go behind the disclosure standard to assess the boardroom process. Given the aspirational nature of this sub-Principle as well as the well-known tendency for self-assessments to err on the positive side, the reviewer should make a judgement based on all the information available about board practices, and not just rely on self-assessments.

Judgement by the reviewer should in the first instance be based on the assessment of sub-Principle IV.A.9., the disclosure of governance structures and policies, and whether such reporting is widespread and considered by investors as meaningful. In jurisdictions where a corporate governance code is either recommended or mandatory, the reviewer can use as an input any jurisdiction-wide reports summarising the implementation statements of companies, including the incidence of compliance. Where corporate governance practices are mandated, there should be an effective enforcement mechanism.

Essential criteria

1) Does the corporate governance framework require or encourage the board to take responsibility for corporate governance practices by:
   a) overseeing compliance with mandatory corporate governance practices including any code mandated by a relevant authority
   b) implementing and overseeing any corporate governance practices recommended in any corporate governance code adopted by a relevant authority and applying to the company, or any code that the company has adopted

c) ensuring that boards explain why they have not adopted certain practices as recommended in a code (when such disclosure is required for non-compliance)

d) monitoring the structure and operation of the board and other corporate governance practices.

Sub-Principle V.D.4.: Selecting, overseeing and monitoring the performance of key executives, and when necessary, replacing them and overseeing succession planning.

Relevant cross references to assess sub-Principle V.D.4.:

Sub-Principle V.E.2., sub-Principle V.E.4.

Likely practices to be examined

In exercising this sub-Principle, boards may be assisted by a nomination committee, tasked with defining the profiles of the CEO and board members, making recommendations to the board on their appointment. Many jurisdictions require or recommend that all or most of the nomination committee directors be independent. The nomination committee may also guide talent management and review policies related to the selection of key executives. Here sub-Principles V.E.2. on specialised board committees and V.E.4. on board evaluation and diversity are relevant. As part of that process, succession planning by the board could also be a long-term strategic tool to support talent management and diversity.

In a number of jurisdictions and companies, the CEO/Chair traditionally take the lead in appointing their successor, a practice not compatible with implementation of the sub-Principle. The sub-Principle is oriented to preventing such entrenchment but is not intended to extend to the case of companies with controlling shareholders who might have a major role in appointing key executives.

In forming an assessment, the reviewer could make use of data from corporate governance rating and executive placement agencies to determine the customary practices in the jurisdiction with respect to the selection and dismissal of CEOs and other key executives. In two tier systems, the supervisory board is usually responsible for appointing the management board, which will normally comprise most of the key executives. However, even where the supervisory board does not appoint the management board, the sub-Principle should be assessed as not implemented.

Essential criteria

1) Does the corporate governance framework require or encourage the board to take responsibility for selecting, overseeing and monitoring the performance of key executives and, when necessary, replacing them and overseeing succession planning (this could include being assisted by a nomination committee)?

Sub-Principle V.D.5.: Aligning key executive and board remuneration with the longer-term interests of the company and its shareholders.

Relevant cross references to assess sub-Principle V.D.5.:

Sub-Principle II.C.5., sub-Principle IV.A.6., sub-Principle V.E.1.

The annotations to the sub-Principle make clear that the concern is with process rather than with a specific outcome: with remuneration policy as well as setting the level and conditions of compensation.

Likely practices to be examined

Along the lines of sub-Principle IV.A.6., it is regarded as good practice for boards to develop and disclose a remuneration policy statement covering board members and key executives, including their remuneration levels. Such policy statements should specify, especially for executives, the relationship between remuneration and performance with ex-ante criteria linked to performance and include measurable standards that emphasise the long-term interests of the company and its shareholders. Measurable standards may relate to total shareholder return and appropriate sustainability goals and metrics that may be used when determining executive remuneration. Where remuneration is not sufficiently closely tied to the long-term, the sub-Principle should not be judged as fully implemented.

Policy statements generally tend to set conditions for payments to board members for extra-board activities, such as consulting. They also often specify terms to be observed by board members and key executives about holding and trading the stock of the company, and the procedures to be followed in granting and re-pricing of options. In some jurisdictions, policy statements provide guidance on the payments to be made when hiring and/or terminating the contract of an executive. The board may also monitor the implementation of the policy statement on remuneration. Sub-Principle II.C.5. states that "in the case of equity-based schemes, their potential to dilute shareholders' capital and to powerfully determine managerial incentives means that they should be approved by shareholders, either for individuals or for the policy of the scheme as a whole." The design of remuneration policies and contracts for board members and key executives is critical to set incentives that align with a company's business strategy, corporate governance framework and risk management.

Many jurisdictions require or recommend that remuneration policy and contracts for board members and key executives be handled by a special committee of the board comprising either wholly or a majority of independent directors and excluding executives that serve on each other's remuneration committees. Information about the arrangements should be an important component of corporate governance disclosure. The essential criteria refer to the use of non-executive board members capable of exercising independent judgement. While not part of this sub-Principle, it is a recommendation set out in sub-Principle V.E.1., at least for board members.

The introduction of malus and claw-back provisions is considered good practice. They grant the company the right to withhold and recover compensation from executives in cases of managerial fraud and other circumstances, for example when the company is required to restate its financial statements due to material noncompliance with financial reporting requirements.

In terms of enforcement, this is an area usually left to shareholders (and thus the importance of sub-Principle II.C.5.) although in some jurisdictions there might also be a breach of the duty of care or loyalty to the company and other stakeholders if the processes are not followed. Regulators may have an enforcement role in the case of regulated institutions.

In forming a judgement about the implementation of the sub-Principle, a reviewer might want to make use of information and examples provided by remuneration consultants and corporate governance rating agencies.

Essential criteria

1) Does the corporate governance framework require or encourage boards to:
    a) develop and publicly disclose a remuneration policy covering key executives and board members that aligns, and explains how it aligns, remuneration with the longer-term interest of the company and its shareholders, including through malus and claw-back provisions

b) ensure that the policy's development, ongoing application and the setting of actual remuneration is overseen by a sufficient number of non-executive board members capable of exercising independent judgement?

Sub-Principle V.D.6.: Ensuring a formal and transparent board nomination and election process.

Relevant cross references to assess sub-Principle V.D.6.:

Sub-Principle II.C.5., sub-Principle IV.A.5.

The sub-Principle assesses the board's role in ensuring effective shareholder participation in board nominations and elections (II.C.5.), emphasising the transparency of these processes, qualifications and selection processes (IV.A.5.).

Likely practices to be examined

The annotations to sub-Principle V.D.6. note as a key role for the board to define the collective or individual profile of board members that the company may need at any given time, considering the appropriate knowledge, competencies and expertise needed to complement the existing skills of the board. The board or its nomination committee has the responsibility to identify potential candidates to meet desired profiles and propose them to shareholders, and/or consider those candidates proposed by shareholders. It is considered good practice to conduct an open search process extending to candidates from a broad range of backgrounds, to respond to diversity objectives and evolving risks to the company. As noted in sub-Principles II.C.5. and IV.A.5., practices in many jurisdictions and companies can be opaque and the election process highly restrictive, such as when a list of candidates is presented for election with no possibilities to oppose individuals or to propose other candidates. In some jurisdictions, there are prohibitions on management and the board acting improperly in soliciting proxies (e.g. paying shareholders for their proxies). Companies with a controlling shareholder and/or block-holders can also be opaque even though it is within their rights to appoint the board.

Many jurisdictions encourage or mandate the use of nomination committees comprising at least a majority of independent board members. Such committees are especially important in jurisdictions where the CEO/Chair or executive board members have traditionally selected new members of the board, and the shareholding structure has been diffuse. In other jurisdictions, major and/or controlling shareholders have frequently been directly involved in the nomination and election process so that the need for an independent nomination committee is less pressing, but the need for transparency is all the greater. Given that company law may be unsuitable in mandating transparent procedures, a number of jurisdictions have found it appropriate to use codes/principles to call for open transparent election processes.

Essential criteria

1) Does the corporate governance framework require or encourage boards to:
   a) adopt procedures that ensure a formal and transparent board nomination process in which potential conflicts of interest are appropriately managed
   b) adopt procedures for the election of board members that ensure effective shareholder participation in the nomination and election process
   c) disclose to shareholders the nomination procedures, including the role and composition of any nomination committee. Is any change or variation from this policy disclosed and justified by the board?

Sub-Principle V.D.7.: Monitoring and managing potential conflicts of interest of management, board members and shareholders, including misuse of corporate assets and abuse in related party transactions.

Relevant cross references to assess sub-Principle V.D.7.:

Principle II.F., Principle II.G., Principle III.E., sub-Principle IV.A.7., sub-Principle IV.A.9., Principle V.A., Principle V.C., sub-Principle V.D.8., sub-Principle VI.D.5.

Sub-Principle V.D.7. can be seen as specifying requirements for the duty of care and loyalty (Principle V.A.) and supports the protection of minority shareholders (Principle II.G.), prohibition of insider trading and market manipulation (Principle III.E.), review of related party transactions and management of conflicts of interest (Principle II.F.). Disclosure of related party transactions and governance structures and policies (sub-Principles IV.A.7. and IV.A.9.) is also relevant for the assessment of this sub-Principle.

Likely practices to be examined

The annotations to sub-Principle V.D.7. make clear that the focus here is on board processes. The board should oversee an internal control system covering financial reporting (for which the assessment of sub-Principle V.D.8. will also be relevant), and the use of corporate assets as well as guard against abusive related party transactions (consistent with assessment of Principle II.F.). The monitoring of this function is often assigned to the internal auditor who should maintain direct access to the board. Where other corporate officers are responsible such as the general counsel, it is important that they maintain similar reporting responsibilities as the internal auditor. In fulfilling its control oversight responsibilities, it is important for the board to oversee the company's whistleblowing policy to ensure the integrity, independence, and confidentiality of whistleblowing processes, and to encourage the reporting of unethical/unlawful behaviour without fear of retribution. This requirement is fully covered in sub-Principle VI.D.5. In forming a judgement about the implementation of this sub-Principle, the reviewer will need to examine the evidence about self-dealing and related party transactions in the jurisdiction and the *de facto* and *de jure* role of the boards. The sub-Principle does not define what is meant by "management" of conflicts of interest, misuse of corporate assets and abusive related party transactions. Several functionally equivalent practices are widely observed. At a minimum, the board must review the disclosure of related party transactions (sub-Principle IV.A.7.). In some jurisdictions, the board (or its committee) must also approve related party transactions while in others it must submit material transactions to shareholder approval. The intent of the Principles (especially Chapter II) is that such a vote should exclude interested shareholders and it would also be expected that interested board members would abstain from approving a transaction, already required in a large majority of jurisdictions. Where there is simply a disclosure obligation and means of recourse are weak, the reviewer should be inclined to a judgement that the sub-Principle is either not or only partly implemented.

In systems in which controlling shareholders predominate, the experience has been that it is the controlling shareholders who may abuse related party transactions and they will also have an important position on the board. While internal controls are still important, the experience has often been that the board or its committees have found it difficult to judge the fairness or otherwise of related party transactions and the use of company assets. In these cases, additional measures to formal internal controls such as those discussed above might also be needed for the board to fulfil its duty.

Internal controls are important to ensure that the ethical code of the company is followed and that there is compliance with applicable laws and regulations covering self-dealing and abusive related party transactions. The reviewer will need to examine internal control standards of the jurisdiction. The practice has been often for the internal control organ to report to the CEO rather than to the board. More recently, in nearly all jurisdictions, implementation of the internal control system is assigned to the board. An audit

committee of the board, ethics committee or equivalent body, may be named as the responsible body. Rather than just note the existence of such bodies, the reviewer should also be satisfied that the evidence suggests that they function effectively in the way envisaged. In some cases, such bodies are hampered by procedural rules and by their membership.

Essential criteria

1) Does the corporate governance framework require or encourage the board to oversee a system of internal controls designed to facilitate monitoring and managing potential conflicts of interest, the use of corporate assets, and the terms of related party transactions?
2) Is the mechanism and the associated sanctions disclosed as part of the board's duty to report on governance structures and policies, and related party transactions (sub-Principles IV.A.7. and IV.A.9.)?
3) Does the corporate governance framework require or encourage the board to manage self-dealing and related party transactions consistent with the duty of board members to act in the best interests of the company and its shareholders?

Sub-Principle V.D.8.: Ensuring the integrity of the corporation's accounting and financial systems for disclosure, including the independent external audit, and that appropriate control systems are in place, in compliance with the law and relevant standards.

Relevant cross references to assess sub-Principle V.D.8.:

Principle IV.A., sub-Principle IV.A.9., Principle IV.B., Principle IV.C., Principle V.A., Principle V.C., sub-Principle V.D.2., sub-Principle V.D.7., sub-Principle V.E.1.

Sub-Principle V.D.8. can be seen as specifying requirements for the duty of care and loyalty (Principle V.A.) and is also essential in underpinning recommendations related to disclosure and independent external audits (Principles IV.A., IV.B., IV.C.). The assessment of the functioning of internal control systems undertaken for sub-Principle V.D.7. may also inform the assessment under this sub-Principle of financial and accounting controls. Sub-Principle V.E.1. complements it by recommending independent board members to oversee the process.

Likely practices to be examined

The annotations indicate that "The board should demonstrate a leadership role to ensure that an effective means of risk oversight is in place. Ensuring the integrity of the essential reporting and monitoring systems will require that the board sets and enforces clear lines of responsibility and accountability throughout the company. The board will also need to ensure that there is appropriate oversight by senior management.''

The annotations further note that companies are advised to implement and maintain effective internal controls, ethics, and compliance programs to adhere to relevant laws, regulations, and standards. This includes compliance with laws as mandated by the OECD Anti-Bribery Convention, and other forms of bribery and corruption. In addition, companies must ensure compliance with laws governing securities, taxes, competition, and workplace safety, along with regulations concerning human rights, environmental protection, fraud, and money laundering. These compliance efforts are fundamental to upholding the company's ethical code. For these programmes to be successful, a company's reward system must promote ethical behaviour and professional standards, ensuring that compliance with the law is incentivised, and violations are penalized effectively. Furthermore, compliance efforts should cover not only the company's internal operations but also extend to its subsidiaries and, where feasible, to external partners such as agents, consultants, distributors, contractors, and partners in consortia and joint ventures.

In practice, the establishment of an internal audit function plays an important role in providing support to the audit committee, or an equivalent body, in its oversight of the company's internal control and operations. The role and functions of internal audit may include assessment and evaluation of governance, risk management, and internal control processes.

It is considered good practice for the internal auditors to report to the audit committee, or an equivalent body that is also responsible for managing the relationship with the external auditor allowing the board to respond in a coordinated manner. The board can maximize the quality of assurance it receives, if both internal and external audit functions are clearly articulated.

It is also considered good practice for the audit committee or an equivalent body to review and report to the board the most critical policies that form the basis of financial and other corporate reports. It is critical that the board retains ultimate responsibility for overseeing the company's risk management system and ensuring the integrity of the company's reporting systems, as specified in the annotation to this sub-Principle.

Some jurisdictions require the chair of the board to report on the internal control process. The Principles recommend that companies with large or complex risks (financial and non-financial), including corporate groups, put in place similar reporting systems, including direct reporting to the board on group-wide risk management and oversight of controls.

A majority of jurisdictions recommend implementing a company-wide internal control and risk management system, beyond ensuring the integrity of financial reporting. This may be associated with comply or explain obligations with respect to a corporate governance code incorporating such systems. Some jurisdictions mandate that companies report on the effectiveness of internal controls involved with financial reporting and include declarations by executives. In some jurisdictions, the external auditors are also required to report on the company's governance or internal controls over financial reporting. If generally implemented by companies, such corporate governance codes should be treated as functionally equivalent with mandated systems, even though the former are often much broader.

Through either principles/codes or in an increasing number of jurisdictions, by secondary market regulation, the board is required to manage relations with the external auditor so as to ensure an independent audit. This includes oversight of the overall relationship with the external auditor including non-audit services they undertake for the company which might compromise their independence. Further comments about what might be implied for managing the relationship are discussed under Principle IV.C. which covers what is required of transparency.

Essential criteria

1) Does the corporate governance framework require or encourage the board to oversee the administration of internal controls designed to ensure:
   a) the integrity of the corporation's accounting and financial reporting systems
   b) that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control? Is the mechanism disclosed as part of the board's duty to report on governance structures and policies (sub-Principle IV.A.9.)?
2) Does the corporate governance framework require or encourage the board to manage the overall relationship with the external auditors so as to be reasonably satisfied that the audit of the financial statements has been conducted in an independent and competent manner?
3) Does the corporate governance framework require or encourage boards to oversee the effectiveness of the company's internal controls, ethics, and compliance programmes or measures, to comply with applicable laws, regulations and standards, including the company's ethical code? Do the programmes ensure that compliance is rewarded, and breaches of law are met with dissuasive consequences or penalties? Do compliance programmes also extend to

subsidiaries and where possible to third parties, such as agents and other intermediaries, consultants, representatives, distributors, contractors and suppliers, consortia, and joint venture partners?

Sub-Principle V.D.9.: Overseeing the process of disclosure and communications.

Relevant cross references to assess sub-Principle V.D.9.:

Principle II.A., Principle II.B., Principle II.C., Principle IV. including Principle IV.E.

The sub-Principle should be seen as a reflection of Chapter IV covering disclosure and transparency, including the board's responsibility for fulfilling Principle IV.E. to provide equal, timely and cost-efficient access to relevant information by users. It refers also to the process underpinning Principles II.A., II.B. and II.C. which specify access to timely and relevant information about a company as a basic shareholder right.

Likely practices to be examined

In many jurisdictions, information is collected by rating agencies and others concerning the quality of disclosure and communications that could aid a reviewer to form a judgement. However, the process of communications with investors is often more subtle and can take place on a bilateral basis. The reviewer should thus seek to determine the judgement of investor groups about the quality of communications in the jurisdiction. In some jurisdictions, the appointment of an investor relations officer who reports directly to the board is considered good practice for publicly traded companies.

Essential criteria

1) Does the corporate governance framework require or encourage the board to: (a) oversee the disclosure of material information about the company; and (b) take responsibility for the company's communications strategy with the shareholders?

Principle V.E.: The board should be able to exercise objective independent judgement on corporate affairs.

Relevant cross reference to assess Principle V.E.:

Principle V.A.

This Principle is an important complement to Principle V.A. on board duties but will still call for a separate judgement by the reviewer. This Principle is probably one of the most difficult for reviewers to form a judgement. The variety of board structures, ownership patterns and practices in different jurisdictions will require different approaches to the issue of board objectivity. The primary concern in some jurisdictions is with independence and objectivity concerning management. Board independence in these circumstances usually requires that a sufficient number of board members will need to be independent of management: not be employed by the company or its affiliates and not be closely related to the company or its management through significant economic, family or other ties. This does not prevent a board member from also being a shareholder. In others, independence from controlling and substantial shareholders will need to be emphasised, in particular if the *ex-ante* rights of minority shareholders are weak and opportunities to obtain redress are limited. This has led to both codes and the law in most jurisdictions to call for some board members to be independent of controlling and substantial shareholders, independence extending to not being a representative or having close business ties with them. While jurisdictions' definitions of what constitutes a substantial shareholder may vary, minimum thresholds are common.

Where there is a party in a special position to influence the company, the intent of the Principle is that there should be stringent tests to ensure the objective judgement of the board.

The annotations further note that some jurisdictions' binding or non-binding regulations describe in detail the situations in which a director is deemed to be non-independent. Jurisdictions also define independence in various ways, such as having no relationships with the company, its group and management, the company's external auditor and controlling shareholders, as well as no direct or indirect remuneration from the company or its group other than directorship fees. The board may also be required to approve a director's independence if the director has no material relationship with the company or any relationship that would prevent them from exercising independent judgement. Many jurisdictions also set maximum terms for directors to be considered independent.

Sub-Principle V.E.1.: Boards should consider assigning a sufficient number of independent board members capable of exercising independent judgement to tasks where there is a potential for conflicts of interest. Examples of such key responsibilities are ensuring the integrity of financial and other corporate reporting, the review of related party transactions, and nomination and remuneration of board members and key executives.

Relevant cross references to assess sub-Principle V.E.1.:

Sub-Principle II.C.5., Principle II.G., sub-Principle IV.A.5., sub-Principle IV.A.6., sub-Principle IV.A.7., Principle V.D.

Sub-Principle V.E.1. makes the connection between the board being able to exercise objective independent judgement to the actual process established to ensure such judgement via the use of certain board members capable of exercising independent judgement. It therefore complements and implements several considerations about the board's key functions noted in Principle V.D.'s sub-Principles. The annotations state that 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 its shareholders may diverge such as executive remuneration, succession planning, changes of corporate control, take-over defences, large acquisitions, and the audit function.

Likely practices to be examined

With respect to Principle V.E., jurisdictions vary widely in how they implement "objective independent judgement" requiring the reviewer to examine several aspects in detail. Many jurisdictions focus on the concept of the "independent" board member, encouraging or mandating a certain percentage of the board to be independent and not just non-executive. However, even where mandated, the definition has sometimes been so narrow as to be easily evaded. For example, although board members from a subsidiary could not be considered as independent in one jurisdiction, those from related companies have been classed as independent. In some cases, the concept has been implemented almost in the form of a legal transplant and, unlike the annotations of the sub-Principle, not adapted to the board and ownership structure of the jurisdiction. In some jurisdictions, the looser concept of an outside board member has been utilised but similar issues as with independent board members have arisen. Where not mandatory but recommended or encouraged, board members have also been considered as independent by companies based on the most favourable interpretation of criteria. The question for the reviewer is not only the definition and whether it is appropriate, but also whether it is applied in practice.

A key question for the reviewer is the incentive structure for board members to want to be, or remain, independent and objective. In several jurisdictions there are expectations that outside or independent board members will monitor potential conflicts of interest involving corrupt managers and controlling

shareholders, and that the threat of liability will enhance their incentives to be vigilant. The reviewer will have to understand the liability system that applies to board members of a jurisdiction, but it is probably too much to expect it to be an effective incentive, and this appears indeed to be the experience around the world. The reviewer should therefore give greater weight to judgements about: the role of shareholders and in particular sub-Principle II.C.5.; the transparency about board members and in particular sub-Principles IV.A.5. and IV.A.6.; and general board processes as covered by sub-Principles V.D.5. and V.D.6.

Another area that needs to be considered and for which data should be available from corporate governance reports concerns the separation of the role of chief executive and chair. In jurisdictions with one-tier boards, separation of the two posts is generally regarded as good practice, as it can help to achieve an appropriate balance of power, increase accountability, and improve the board's capacity for decision making, independent of management. The designation of a lead director is also regarded as a good practice alternative in some jurisdictions if that role is defined with sufficient authority to lead the board in cases where management has clear conflicts. A large majority of jurisdictions require or recommend the separation of functions of the CEO and the chair. Even if separation is not mandated, many companies are adopting the separation rule. Where the practice is widespread, the reviewer should be inclined to the judgement that the sub-Principle is implemented. However, this judgement would be dependent on the ownership structure in a jurisdiction and on the state of minority rights (Principle II.G.), and disclosure (sub-Principle IV.A.7.) and control of related party transactions (sub-Principle V.D.7.). The annotations highlight that in two-tier systems, "consideration should be given to whether corporate governance concerns might arise if there is a tradition for the head of the lower board becoming the chair of the supervisory board on retirement."

In some jurisdictions, sub-Principle V.E.1. is implemented indirectly via the courts which give the benefit of the doubt to the decisions of the board when it is clear that board members capable of independent judgement have been closely involved in a disputed decision. Here the decision is often based on a full consideration of the circumstances rather than *ex-ante* tests of independence. This is often the case, for example, with related party transactions and with the sale and acquisition of assets. In other cases, the use of board members classified as independent by the board is sometimes mandated.

With cross reference to sub-Principle V.D.7., it is increasingly common for external auditors to be recommended by an independent audit committee of the board or an equivalent body and to be appointed either by that committee/body or by shareholders directly. The audit committee or an equivalent body is often specified as providing oversight of the internal audit activities and is also charged with overseeing the overall relationship with the external auditor including the nature of non-audit services provided by the auditor to the company. Some jurisdictions mandate such a role for independent board members while in others it is often a key element of codes/principles.

Since a majority of jurisdictions require or recommend disclosure of information regarding a board candidate's relationship with the company, a number of rating agencies have collected data on the level of company compliance with sub-Principle V.E.1., which will be useful for a reviewer in forming a judgement. However, the judgement will also have to take into account the definition of independence in the jurisdiction and the actual experience. In defining independence for members of the board, some national codes of corporate governance or exchange listing standards have specified quite detailed presumptions for non-independence. While establishing necessary conditions, such "negative" criteria defining when an individual is *not* regarded as independent can usefully be complemented by "positive" examples of qualities that will increase the probability of effective independence. Even where a sub-committee might comprise a majority of independent board members, if it is also chaired by the CEO/chair the group as a whole might not be capable of objective independent judgement. The overall legal context also matters.

Essential criteria

1) Does the corporate governance framework require or encourage:
   a) a proportion of the board to be independent
   b) set out criteria for independence that address the primary agency conflicts that arise because of the ownership and control structures in the jurisdiction and are not easily by-passed
   c) place the onus on companies to declare who they regard as independent and the reasons?
2) Does the corporate governance framework require or encourage a sufficient number of non-executive board members capable of exercising independent judgement to oversee tasks where there is a potential for conflict of interest including:
   a) oversight of the integrity of financial and non-financial reporting including external audit
   b) review and management of related party transactions and self-dealing
   c) nomination of board members and key executives
   d) board and executive remuneration?

Sub-Principle V.E.2.: Boards should consider setting up specialised committees to support the full board in performing its functions, in particular the audit committee – or equivalent body – for overseeing disclosure, internal controls and audit-related matters. Other committees, such as remuneration, nomination or risk management may provide support to the board, depending upon the company's size, structure, complexity and risk profile Their mandate, composition and working procedures should be well defined and disclosed by the board which retains full responsibility for the decisions taken.

Relevant cross reference to assess sub-Principle V.E.2.:

Sub-Principle IV.A.9., sub-Principle V.E.1.

As noted above, independent board members often serve on committees, which can enhance the board's effectiveness by focusing on specific areas, depending on the company's size, structure, sector, development, and board needs. It is important for the market to understand these committees' mandates, scope, procedures, and composition, as outlined in sub-Principle IV.A.9. This ensures that an assessment of sub-Principle V.E.2. aligns with these disclosures.

Likely practices to be examined

The disclosure advocated by this sub-Principle is particularly important in the many jurisdictions where boards are required to establish independent audit committees with powers to oversee the relationship with the external auditor. Audit committees should also be able to oversee the effectiveness and integrity of the internal control system, which may include monitoring of the internal control system by the internal audit function. Most jurisdictions establish binding rules for the conduct and functions of an independent audit committee and recommend nomination and remuneration committees on a "comply or explain" basis. With respect to risk committees in the non-financial sector, a number of jurisdictions require or recommend assigning this role to either the audit committee or a dedicated risk committee. The separation of the functions of the audit and risk committees may be valuable given the greater recognition of risks beyond financial risks, to avoid audit committee overload and to allow more time for risk management issues.

Depending on their needs, some boards have created a sustainability committee to advise on social and environmental risks, opportunities, goals, and strategies, including related to climate. Some boards have also established a committee to advise on the management of digital security risks as well as on the company's digital transformation.

It is important to note that committees have an advisory role and that the board as a whole is responsible for the decisions taken. Its oversight and accountability should be clearly reflected in the corporate governance framework.

Essential criteria

1) If special board committees are established, such as a sustainability, digital security, risk or other specific committee, do they have access to the necessary information to comply with their duties, receive appropriate funding and are able to engage outside experts or counsel?
2) Is the board's oversight and accountability clear, including that the board as a whole remains fully responsible for the decisions taken, unless legally defined otherwise?
3) Does the corporate governance framework require the audit committee to take responsibility for reviewing important functions such as financial disclosure, internal control, and other internal and external audit-related matters, or in cases where there is some discretion, to clearly assign the responsibility to an equivalent body or the board? Does the framework require or encourage companies to assign a sufficient number of independent directors to carry out the audit committee's (or equivalent body's) functions?

Sub-Principle V.E.3.: Board members should be able to commit themselves effectively to their responsibilities.

Relevant cross references to assess sub-Principle V.E.3.:

Sub-Principle IV.A.5., sub-Principle V.D.6.

This sub-Principle supports the board's objective, independent judgement. Serving on numerous boards or committees can hinder board members' performance, so disclosing other board memberships to shareholders is crucial for improving board nominations. This complements sub-Principle V.D.6., which emphasises the board's responsibility to identify potential members with suitable knowledge, competences, and expertise.

Likely practices to be examined

Some jurisdictions have limited the number of board positions that can be held by an individual. Specific limitations may be less important than ensuring that members of the board enjoy legitimacy and confidence in the eyes of shareholders. Achieving legitimacy would also be facilitated by the publication of attendance records for individual board members (e.g. whether they have missed a significant number of meetings) and any other work undertaken on behalf of the board and the associated remuneration. Such transparency is advocated by sub-Principle IV.A.5. which calls for disclosure of information about board members including their qualifications.

Essential criteria

1) Does the corporate governance framework require or encourage companies to provide comprehensive disclosure about each board member's activity including: (a) the member's length of service as a board member and their tenure on various board committees; (b) basic information about primary employment, if any; (c) other board positions held concurrently; (d) attendance records at board and committee meetings; and (e) any other work undertaken on behalf of the board and the associated remuneration?

Sub-Principle V.E.4.: Boards should regularly carry out evaluations to appraise their performance and assess whether they possess the right mix of background and competences, including with respect to gender and other forms of diversity.

Relevant cross references to assess sub-Principle V.E.4.:

Sub-Principle IV.A.5.

This sub-Principle promotes board evaluation as a mechanism to assess whether the board collectively possesses the right background and competences to enhance practices as well as performance. The annotations highlight the importance of fostering diverse perspectives to better inform decision-making and avoid groupthink. Evaluations may consider diversity criteria such as gender, age or other demographic characteristics, as well as expertise in areas like accounting, digitalisation, sustainability, risk management, or specific sectors.

Likely practices to be examined

Many jurisdictions recommend that boards undergo evaluations addressing their performance, composition and training needs. In some jurisdictions, it is recommended that nomination committees evaluate the balance of skills, experience, independence and knowledge on the board for a particular appointment to the board. In addition, some jurisdictions recommend establishing a mechanism and criteria for a self-assessment of performance by each member of the board. For a comprehensive and overall evaluation of boards, self-assessments or using the service of an independent external party is recommended.

In some jurisdictions, publicly traded companies are required to disclose in their annual reports director training programmes or other recommended measures to improve board practices and performance.

In support of diversity objectives, many jurisdictions require or recommend that publicly traded companies disclose the gender composition of boards and of senior management. Some jurisdictions have established mandatory quotas or voluntary targets for female participation on boards with tangible results. Jurisdictions and companies should also consider additional and complementary measures to strengthen the female talent pipeline throughout the company and reinforce other policy measures aimed at enhancing board and management diversity.

Some jurisdictions adopt a range of approaches to promote greater diversity on boards. The progress achieved in achieving gender diversity improvements in jurisdictions with no quota or target in place shows that alternative and complementary measures ranging from shareholder initiatives in support of greater diversity to promoting a more enabling environment for the advancement of women on boards and in leadership positions can also play an important role in achieving results. Complementary measures may emanate from government, private and public-private initiatives and take the form of advocacy and awareness-raising activities: networking, mentorship and training programmes; establishment of supporting boards (women business associations); certification, awards or compliant company lists to active peer pressure; and the review of the role of the nomination committee and of recruitment methods. Some jurisdictions have also established guidelines or requirements intended to ensure consideration of other forms of diversity, such as with respect to experience, age and other demographic characteristics. These are, however, not required for the sub-Principle to be assessed as implemented.

Essential criteria

1) Does the corporate governance framework require or encourage boards to regularly assess the performance of the board as a group and its standing committees, as well as the performance of

each board member and the senior executive officers, and to identify areas for improvement with a plan for such an improvement?

2) Does the corporate governance framework require or encourage measures such as voluntary targets, disclosure requirements, boardroom quotas, or other public and/or private initiatives to enhance gender diversity on boards and in senior management?
3) Does the corporate governance framework require or encourage boards to provide initial and ongoing training to board members relevant to the performance of their individual duties?

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

Relevant cross references to assess Principle V.F.:

Principle V.A.

Board members require timely, relevant information for decision-making. As non-executive board members do not typically have the same access to information as executive board members, it is both their responsibility and that of the entire board to ensure timely access to accurate information necessary for decision-making. In cases where a publicly traded company is the parent company of a group, regulatory frameworks should guarantee access to key information about the activities of its subsidiaries to manage group-wide risks and implement group-wide objectives. Committees should facilitate information flow to the entire board. Safeguards should ensure that insiders will not use such information for their personal gain or that of others. This Principle applies to executive board members as well.

Likely practices to be examined

There are numerous instances around the world of boards not being informed by management of all the facts and being requested to make important decisions without adequate time for consideration and without adequate information. The situation makes it impossible for the board and its members to fulfil its duty of care. Adequate information also means that board members are put in a position to be able to appreciate the relevance and meaning of the information provided. The reviewer should review recent public cases and interview market participants for indications that the board is treated in this manner by management and/or controlling shareholders. Where there is evidence that the practice is common the Principle should be assessed as only partly implemented. The assessment of Principle V.A. should also be consistent with this judgement.

Increased resort to non-executive board members has raised the issue of their access to information commensurate with their responsibilities in a number of jurisdictions. In cases where there are no direct references in either the law or codes to board access to information but also no evidence of any problem, the reviewer should be inclined to a judgement of partly implemented. Some jurisdictions require or recommend providing them with access to certain key managers within the company such as, for example, the company secretary, the internal auditor and the head of risk management or chief risk officer, and recourse to independent external advice at the expense of the company.

A special case concerns proposed transactions or activities that fall outside the company’s routine course of business. In some jurisdictions, boards are provided with timely advice, at no cost to them, from qualified advisors (e.g. lawyers, accountants, financial advisors as appropriate) about the processes they should follow and factors they should consider in fulfilling their duties of loyalty and care to the company in the context of the transaction or activity. The process is made clear in filings about the decision-making process. The reviewer will need to rely on such disclosures. Where they are not forthcoming, and in combination with other information about the functioning of boards, the reviewer should be inclined to assess the Principle as either not or as only partly implemented.

Essential criteria

1) Does the corporate governance framework require or encourage both executive and non-executive board members to be provided with access to information that they consider relevant for the fulfilment of their responsibilities? Where companies rely on complex risk management models, are board members made aware of the possible shortcomings of such models?
2) In connection with proposed transactions or activities that fall outside the company's routine course of business, do company disclosures indicate that the boards have been provided with timely advice, at no cost to them, from qualified advisors (e.g. lawyers, accountants, financial advisors as appropriate) about the processes they should follow and factors they should consider in fulfilling their duties of loyalty and care to the company in the context of the transaction or activity? Do company disclosures indicate that board members who are asked to participate in independent committees are able to retain independent advisors as they see a need, and such advice is paid for by the company?

Principle V.G.: When employee representation on the board is mandated, mechanisms should be developed to facilitate access to information and training for employee representatives, so that this representation is exercised effectively and best contributes to the enhancement of board skills, information and independence.

Relevant cross references to assess Principle V.G.:
Sub-Principle VI.D.3. and sub-Principle VI.D.4.

Employee representation on boards can be mandated by law or collective agreements or can be adopted voluntarily. Either way, the Principle recommends that it be applied in a way that maximises its contribution to the board's independence, competence, information and diversity. Sub-Principles VI.D.3. on mechanisms for employee participation and VI.D.4. about their access to information can also provide helpful guidance in the assessment of Principle V.G.

Likely practices to be examined

While systems for employee board representation differ among jurisdictions, the systems should be applied in a way that maximises the contribution to each of the aspects mentioned in the Principles and the annotations. As stated in the Principle, the latter applies only in cases when employee representation on the board is mandated, so should only be assessed in those cases.

Essential criteria

1) When employee representation on the board is mandated, does the corporate governance framework require or encourage the establishment of procedures to facilitate access to information, training and expertise of employee board representatives, including, provided that board confidentiality requirements are duly respected, rights to report regularly to employees?
2) When employee representation on the board is mandated, does the corporate governance framework require or encourage the establishment of procedures to ensure the independence of employee board members from the CEO and executives? Do these procedures include adequate, transparent appointment procedures, and clear procedures for managing conflicts of interest?

Chapter VI: Sustainability and resilience

Introduction

The chapeau principle states that "The corporate governance framework should provide incentives for companies and their investors to make decisions and manage their risks, in a way that contributes to the sustainability and resilience of the corporation."

The new chapter on sustainability and resilience presents a range of recommendations on corporate disclosure, the dialogue between a company and its shareholders and stakeholders on sustainability-related matters, the role of the board in addressing these matters, and the interests of stakeholders.

The corporate governance framework should allow investors and companies to consider and manage potential climate and other sustainability risks and opportunities. A consistent, comparable and reliable disclosure of material information should support investors in making informed financial, investment and voting decisions. This, in turn, will promote market efficiency and strategic capital allocation, while supporting companies' long-term growth and resilience.

Policy makers should work on limiting excessive listing costs, ensuring clear and comparable information to investors and promoting dialogue with different stakeholders without undermining the financial interests of shareholders.

Issues and assessment criteria

Principle VI.A.: Sustainability-related disclosure should be consistent, comparable and reliable, and include retrospective and forward-looking material information that a reasonable investor would consider important in making an investment or voting decision.

Relevant cross references to assess Principle VI.A.:

Sub-Principle IV.A.2.

Investors should have access to sufficient information to make informed decisions, both in terms of capital allocation and engagement with the companies.

The Principle encourages the disclosure of sustainability-related information from both a historical and a forward-looking perspective. Sustainability-related disclosure should provide investors with high-quality information that can reasonably be expected to influence the assessment of a company's value, thereby enabling comparability across markets and companies. The Principle is also reflected in sub-Principle IV.A.2., which encourages the disclosure of material policies and performance metrics related to environmental and social matters.

Likely practices to be examined

In light of increasing awareness of environmental and social risks, investors are calling for enhanced disclosure from companies. This includes information on governance, strategy, risk management, and sustainability-related metrics that could affect a company's value. Sustainability-related disclosures are deemed critical for investors in evaluating a company's risk profile and its expected performance.

Sustainability-related disclosures can also benefit other key stakeholders. For instance, employees can benefit from the disclosure of workforce's representation mechanisms and collective bargaining coverage.

In developing new sustainability-related disclosure frameworks, policy makers should consider introducing flexible rules to take into account the existing capacities of companies and relevant institutions. Sustainability-related disclosure represents a cost for companies, which may be relatively fixed regardless of the size of the company or its stage of development. Policy makers should consider that smaller companies, which face the relatively higher costs of accounting and reporting on sustainability-related information compared to larger companies, may not be sufficiently incentivised by the benefits of attracting additional funding from investors concerned about sustainability.

Phased-in implementation for sustainability-related disclosure may help companies and policy makers to develop good practices and adequate processes.

The assessment of this Principle should take into consideration the assessments of sub-Principles VI.A.1. through VI.A.5., as well as the related assessment of sub-Principle IV.A.2., which specifies that disclosure should include material information on company objectives and sustainability-related information.

Sub-Principle VI.A.1.: Sustainability-related information could be considered material if it can reasonably be expected to influence an investor's assessment of a company's value, investment or voting decisions.

While this sub-Principle provides for some flexibility as to how materiality of sustainability-related information may be determined, its annotations also provide some useful context and considerations for how a jurisdiction may implement the broader overarching Principle VI.A. Sustainability-related information is typically deemed material if it can reasonably be expected to influence investors' analysis of a company's future cash flows and risk profile and if its omission or misstatement could influence investment or voting decisions. The determination of which information is material may vary over time, and according to the local context, company-specific circumstances, and jurisdictional requirements.

Likely practices to be examined

Many jurisdictions require or recommend listed companies to disclose sustainability-related information provided by codes or principles, including frameworks set by the regulator or stock exchange following a "comply or explain" approach.

Environmental and social matters can affect the companies' value in several ways. For instance, the ability of a company to reduce greenhouse gas (GHG) emissions can enhance its resilience to climate-related risks, providing advantages when carbon taxes are implemented or attracting financial flows from a new investor base. Moreover, human capital management can influence the competitiveness of the company and foster workforce productivity.

In assessing the materiality of environmental and social issues, companies should take into consideration the local context, company-specific circumstances and jurisdictional requirements, as well as the views of relevant stakeholders and how they may evolve over the longer term.

The identification of the most relevant sustainability matters for companies may be considered by standard-setters and regulators when setting their agenda priorities for the future.

The disclosure of material sustainability-related information can enhance investors' capability to effectively handle the overall risks of their portfolios, and of financial stability supervisors to anticipate systemic risks.

Essential criteria

1) Do regulators monitor companies' assessment of material sustainability-related disclosure? If they do, does this assessment take into account the local context, company-specific circumstances, and different jurisdictional requirements?

Sub-Principle VI.A.2.: Sustainability-related disclosure frameworks should be consistent with high quality, understandable, enforceable and internationally recognised standards that facilitate the comparability of sustainability-related disclosure across companies and markets.

Relevant cross references to assess sub-Principle VI.A.2.:

Principle VI.A.

Comparability between sustainability-related disclosures, including across different jurisdictions, improves capital markets' efficiency, helping investors to adequately value companies and, therefore, to decide how best to allocate their capital and engage with companies. Consistency and interoperability between standards should be read in conjunction with the possibility to develop complementary regional or jurisdictional frameworks. This flexibility is particularly important for addressing matters influenced by specific geographical or market characteristics and jurisdictional requirements that may impact the materiality of certain sustainability factors. Nonetheless, in considering the adoption of local reporting frameworks, jurisdictions should seek to minimise any disparities with international standards to facilitate the comparability of disclosures across markets.

The assessment should be consistent with that for Principle VI.A., which encourages the disclosure of retrospective and forward-looking material information to allow reasonable investors to make investment and voting decisions.

Likely practices to be examined

Different sustainability accounting and reporting standards are currently in use globally. Policy makers and market participants may eventually recognise the sustainability standards already developed by international standard setters capable to facilitate the comparability of sustainability-related disclosure across companies and markets. In parallel, international standard setters may work together to make their standards as interoperable as feasible, minimising reporting and accounting costs for companies required to disclose sustainability-related information according to different standards.

Enhanced comparability among reporting standards may enable directors and executives not only to address specific inquiries from different stakeholders, but also to benchmark the sustainability performance of their company in comparison to their peers.

Essential criteria

1) Does the corporate governance framework require or encourage the disclosure of sustainability-related information to be consistent with a specific internationally recognised standard? If a national sustainability-related disclosure framework is adopted, is the framework consistent and interoperable with internationally recognised standards?

Sub-Principle VI.A.3.: Disclosure of sustainability matters, financial reporting and other corporate information should be connected.

The same level of rigour applied to measuring and reporting financial information should also be applied to sustainability-related information. If considered material, both sustainability-related information and financial information enable investors to make informed investment and voting decisions. Such connectivity ensures the consideration of material sustainability matters in financial estimates, assumptions, and risk disclosures.

Essential criteria

1) Does the corporate governance framework require or encourage the same level of rigour for the disclosure of sustainability-related and financial information considered material?

Sub-Principle VI.A.4.: If a company publicly sets a sustainability-related goal or target, the disclosure framework should provide that reliable metrics are regularly disclosed in an easily accessible form to allow investors to assess the credibility and progress towards meeting the announced goal or target.

The disclosure of sustainability-related goals can affect investors' assessment of a company's value and financial performance while attracting a broader investor base.

The reporting framework should encourage a comprehensive and consistent disclosure of metrics. To enhance credibility and transparency, the disclosure related to sustainability-related goals may include timely disclosures with interim targets and relevant sustainability metrics, as well as possible corrective actions to address underperformance against a target. This would allow investors to analyse the company's progress and performance against a set sustainability-related goal.

Likely practices to be examined

Shareholders may benefit from corporate disclosure to efficiently engage with companies and to influence and support the climate transition of those companies. The disclosure of goals and targets allows investors to assess the credibility and progress of such transition.

Many jurisdictions already require or recommend the disclosure of metrics for sustainability-related goals, either through laws and regulations, listing rules or codes and principles.

When setting sustainability-related goals, a company should ensure that the chosen metrics are consistent, comparable and reliable. One of the most relevant sustainability-related metrics for companies' targets is GHG emissions. In that case, a number of companies indicate the baseline year and interim targets, which, together with a consistent annual disclosure and the identification of corrective actions, may offer a comprehensive understanding and a long-term perspective of the targets.

Essential criteria

1) Is there a disclosure framework in place that provides that, if a company publicly sets a sustainability-related goal or target, regular and easily accessible metrics should be disclosed that allow for the meaningful assessment of the company's progress?

Sub-Principle VI.A.5.: Phasing in of requirements should be considered for annual assurance attestations by an independent, competent and qualified attestation service provider in accordance with high quality internationally recognised assurance standards in order to provide an external and objective assessment of a company's sustainability-related disclosure.

An independent assurance for sustainability-related disclosure may improve the level of transparency and reliability of the sustainability-related information. This, in turn, may increase investors' confidence and facilitate comparisons between companies.

Likely practices to be examined

A growing number of jurisdictions have established specific requirements for the assurance of sustainability-related information that apply to at least large, listed companies. Globally, “limited” assurance is considerably more common than “reasonable” assurance, in the case of the attestation of both sustainability reports and specific sustainability-related metrics such as GHG emissions.

International standards for assurance may improve comparability of sustainability-related disclosures and, in the longer term, lead to a greater convergence of the level of assurance between financial and sustainability reports.

Since providing a level of assurance comparable to financial statements for all disclosed sustainability-related information may be too costly, policy makers may consider during an initial period requiring mandatory assessment only for the most relevant sustainability-related metrics or disclosures, such as GHG emissions. In any case, a greater convergence of the level of assurance between financial statements and sustainability-related disclosures should be targeted in the long-term.

Essential criteria

1) Does the corporate governance framework require or encourage the assurance attestations of a company’s sustainability-related disclosure? If not, does the jurisdiction plan to phase in such an assurance framework in the medium to long-term?
2) Does the corporate governance framework require or encourage the implementation of a phase-in period, e.g. requiring mandatory assurance only of the most relevant sustainability-related information?

Principle VI.B.: Corporate governance frameworks should allow for dialogue between a company, its shareholders and stakeholders to exchange views on sustainability matters as relevant for the company’s business strategy and its assessment of what matters ought to be considered material.

Relevant cross references to assess Principle VI.B.:
Principle II.C., Principle III.A., Principle V.A.

The assessment should be consistent with that for Principle V.A., which specifies that boards “should act on a fully informed basis […] and in the best interest of the company and the shareholders, taking into account the interests of stakeholders”. Dialogue between the company, its shareholders and stakeholders on sustainability issues may support the board in making decisions in the interest of the company’s long-term success and performance, as well as in the interest of its shareholders. Principle II.C. and its sub-Principles’ recommendations supporting shareholders’ rights to participate effectively and vote in general shareholder meetings will also be relevant to an assessment of this Principle. The Principle is also reflected in Principle III.A., which encourages investors’ engagement with their investee companies.

Likely practices to be examined

Interaction between the company, shareholders and stakeholders builds trust in the company’s business strategy. Dialogue can generate long-term benefits and help to assess which sustainability matters are material and, therefore, should be disclosed. Many companies already disclose policies on shareholder engagement, including, for instance, how shareholders can question the board or the management or table proposals at shareholder meetings.

Companies should adhere to the principle of equitable treatment of shareholders when engaging in dialogue with them.

Essential criteria

1) Does the corporate governance framework allow for and encourage companies to exchange views with their shareholders and stakeholders on sustainability matters?
2) Are companies' directors and executives allowed to interact with investors also outside general shareholder meetings, with suitable provisions to ensure equitable treatment and equal access to information?

Sub-Principle VI.B.1.: When corporate governance frameworks allow for existing companies to adopt corporate forms that incorporate both for-profit and public benefit objectives, such frameworks should provide for due consideration of dissenting shareholder rights.

Relevant cross references to assess sub-Principle VI.B.1.:
Principle II.E.

The sub-Principle encourages regulatory frameworks that allow companies to adopt public benefit objectives to establish mechanisms that ensure fair consideration of dissenting shareholder rights. These could be ensured by requiring the consent of minority shareholders or a supermajority shareholders' approval before a company can incorporate public benefit goals into its articles of association. Additionally, dissenting shareholders might be granted the right to sell their shares back to the company at a fair price.

The assessment should be consistent with that for Principle II.E., which encourages equal treatment of shareholders and requires shareholders' approval for any changes in economic or voting rights that can negatively affect the shares of the company.

Likely practices to be examined

Several jurisdictions have introduced new legal frameworks for for-profit corporations interested in embracing objectives beyond solely maximising long-term profits. The legal frameworks usually result in a legal obligation for companies and their directors to balance shareholder interests with the public benefits identified in their articles of association. However, shareholders have the right to oppose the transformation in the company's purpose.

While the current number of companies that incorporate both for-profit and public benefit objectives is still relatively low, the rise in their numbers may raise the attention of policy makers and regulators to ensure the protection of shareholder rights.

Essential criteria

1) When existing companies integrate both for-profit and public benefit objectives, does the corporate legal framework provide mechanisms to ensure fair consideration of dissenting shareholders rights?

Principle VI.C.: The corporate governance framework should ensure that boards adequately consider material sustainability risks and opportunities when fulfilling their key functions in reviewing, monitoring and guiding governance practices, disclosure, strategy, risk management and internal control systems, including with respect to climate-related physical and transition risks.

Relevant cross references to assess Principle VI.C.:
Principle V.A., Principle V.D. and its sub-Principles

The board plays an important role in ensuring adequate consideration of material opportunities and risks. To do so, it must ensure that effective governance and internal controls are in place to improve the reliability and credibility of sustainability-related information and disclosure. This is in line with Principle V.A., recommending boards to fulfil their functions "in the best interest of the company and the shareholders, taking into account the interests of stakeholders." Also relevant are several of the more detailed sub-Principles addressing key board functions including risk management (V.D.2.); monitoring of the company's governance practices (V.D.3.); oversight of executive performance and remuneration (V.D.4. and V.D.5.); and of internal audit and control systems (V.D.7. and V.D.8.). This may involve assessing how boards take account of sustainability issues in their evaluations of companies' risk profiles, executive remuneration and nomination processes, and how they align sustainability matters with board and committee strategies.

As defined in the annotations, "OECD due diligence standards on responsible business conduct can provide an important framework for embedding sustainability factors in risk management systems and processes."

Likely practices to be examined

Boards may assess if and how sustainability matters affect companies' risk profiles. Such assessments may also relate to key executive remuneration, including the assessment of sustainability matters when establishing key executives' compensation. Nonetheless, sustainability-linked remuneration may increase executive incentives to portray the sustainability-related performance of the company as positively as possible. In the case where the company engages the same firm to audit its financial statements and to assure its sustainability-related disclosure, investors and regulators may need to pay special attention to whether, for instance, executives can choose to hire the external auditor to provide sustainability-related assurance without the approval of the board, the audit committee or shareholders.

Essential criteria

1) Does the corporate governance framework require or encourage boards to adequately consider material sustainability risks and opportunities when fulfilling their key functions?

Sub-Principle VI.C.1.: Boards should ensure that companies' lobbying activities are coherent with their sustainability-related goals and targets.

Boards should effectively oversee the lobbying activities conducted and financed by the management, ensuring that such activities are consistent with the board's long-term strategy for sustainability.

Likely practices to be examined

The board of directors may have a role in overseeing the lobbying activities that could influence environmental and social policies, law, or regulations. The board could be particularly vigilant in the case of companies in the highest emitting sectors, as executives in these companies may prioritise short-term

interests by avoiding new climate-related regulation, even if the company's long-term strategy is to align its business with an orderly transition to a low carbon economy.

Essential criteria

1) Does the corporate governance framework require or encourage boards to ensure that companies' lobbying activities are coherent with their sustainability-related goals and targets? Are there any disclosure requirements or recommendations on corporate lobbying activities? In the absence of such requirements or recommendations, do publicly traded companies within the jurisdiction generally have a reputation to have ensured a coherent approach between their lobbying activities and sustainability-related goals and targets in practice?

Sub-Principle VI.C.2. Boards should assess whether the company's capital structure is compatible with its strategic goals and its associated risk appetite to ensure it is resilient to different scenarios.

Likely practices to be examined

The management and board members play a crucial role in ensuring the company's financial soundness and evaluating the alignment of the capital structure with strategic goals and risk appetite, taking into account shareholder restrictions and different scenarios.

Essential criteria

1) Does the corporate governance framework require or encourage boards to assess whether the company's capital structure is compatible with its strategic goals and resilient to different scenarios? Does the corporate governance framework require or encourage boards to diligently assess the capital structure in listed companies?

Principle VI.D.: The corporate governance framework should consider the rights, roles and interests of stakeholders and encourage active co-operation between companies, shareholders and stakeholders in creating value, quality jobs, and sustainable and resilient companies.

Relations between a range of different resource providers including, among others, the workforce, creditors, customers, suppliers and affected communities will contribute to the ultimate success of a corporation. The governance framework should consider the interests of stakeholders and their contribution to the long-term success of the company.

The reviewer must therefore be aware of general practices in the jurisdiction, collecting information from investors and stakeholders, and take these into account when forming an assessment about whether Principle VI.D. is implemented. Assessment of the more specific sub-Principles VI.D.1. through VI.D.7. are also relevant for an overall assessment of Principle VI.D.

Sub-Principle VI.D.1.: The rights of stakeholders that are established by law or through mutual agreements are to be respected.

Relevant cross references to assess sub-Principle VI.D.1.:

Principles V.A., sub-Principles VI.D.2., VI.D.3., VI.D.5., VI.D.7.

The rights of stakeholders are often established by labour, business, commercial, environmental, and insolvency laws or by contractual relations supported by these legal frameworks. The sub-Principle is also

reflected more generally in Principle V.A. which requires that the board takes into account the interests of stakeholders when making business decisions in the interest of the company's long-term success and performance and in the interest of its shareholders. The enforceability of stakeholder rights is dealt with by sub-Principle VI.D.2. An assessment against this sub-Principle should also take into account the assessments of how stakeholders' rights are treated under subsequent sub-Principles in this chapter dealing with, for example, employee participation (sub-Principles VI.D.3.), whistleblowing policies that ensure protection of worker rights (VI.D.5.) and creditor rights (VI.D.7.).

Likely practices to be examined

Some jurisdictions define the objectives of companies and the accountability of the board to include stakeholders, but this is left vague, and the jurisprudence is often scarce. In others, the boards are held liable if, for example, labour law and creditor rights are not respected. The reviewer's assessment would benefit from an understanding of court rulings and regulatory decisions that may clarify how such laws should be applied in practice.

Even in areas where stakeholder interests are not legislated, many companies make additional commitments to stakeholders out of concern over corporate reputation and also as part of a corporate strategy to promote a productive co-operative environment. Where applicable, the jurisdiction's experience with implementation of the OECD Guidelines for Multinational Enterprises and associated due diligence standards for risk-based due diligence should be taken into account (OECD, 2023[2]).

Essential criteria

1) Does the corporate governance framework require and support compliance with established legal and contractual rights, for example through disclosure or adoption of internal control systems? If so, have such requirements proven to be effective in ensuring compliance with stakeholder rights?
2) Are there any remedial mechanisms in case of violation of rights? If so, have such mechanisms proven to be broadly effective?

Sub-Principle VI.D.2.: Where stakeholder interests are protected by law, stakeholders should have the opportunity to obtain effective redress for violation of their rights at a reasonable cost and without excessive delay.

Relevant cross references to assess sub-Principle VI.D.1.:
Sub-Principle VI.D.1., sub-Principle VI.D.7.

The sub-Principle is reflected more generally in sub-Principle VI.D.1., which calls for the respect of the rights of stakeholders protected by law or mutual agreements. The case of creditors is handled separately in sub-Principle VI.D.7.

Likely practices to be examined

In a number of jurisdictions, a common complaint from stakeholders (especially workers but sometimes also business partners and suppliers) is that while their legal rights might be well established, the laws are either not enforced or, because of procedural and other rules such as the difficulty to communicate with other stakeholders, are unenforceable and redress is unobtainable. In many cases, especially those concerning workers, enforcement and redress might be handled by special courts and institutions such as arbitration tribunals, which may entail high costs. More generally, the enforcement of stakeholder rights may also be subject to the effective and efficient functioning of the courts along the lines described in the introduction to Chapter II on relevant elements for an assessment of the enforcement of shareholder rights. Applying such consideration to the enforcement of stakeholder rights, an assessor might consider

assessing data, when available, on the extent of successful cases involving violation of worker rights and average time and cost to obtain redress from an employer.

Essential criteria

1) Are effective mechanisms provided to ensure and enforce stakeholders' legal rights?
2) Do the existing mechanisms in place provide adequate remedy for stakeholders whose rights have been violated?

Sub-Principle VI.D.3.: Mechanisms for employee participation should be permitted to develop.

The corporate governance framework can facilitate the development of mechanisms to promote employee participation. Examples of mechanisms for employee participation may include employee representation on boards and governance processes such as works councils, and that performance enhancing mechanisms include stock ownership plans and other profit-sharing mechanisms. Pension commitments can also be an element of the relationship between the company and its past and present employees.

Likely practices to be examined

The degree to which employees participate in corporate governance depends on national laws and practices, and may vary from company to company as well. When mechanisms for employee participation are not mandated, there should be no legal barriers to their adoption if the sub-Principle is to be assessed as fully implemented.

In some jurisdictions, pension funds have been established with both the company and the employees contributing. However, in many cases the company has retained control over the fund choosing to invest in the shares of the company itself and to assign the voting rights to a member of the company, usually the chair or CEO. While these arrangements have been justified by the need to prevent commitments being made on behalf of the company without its permission, official reports in several jurisdictions have indicated that more balance in the oversight of the pension funds is needed. Where no provision is made for company pension funds due, for example, to exclusive reliance on a publicly funded system, the associated criterion should be assessed as not applicable.

Essential criteria

1) Does the corporate governance framework allow or facilitate companies to develop any form of employee participation, such as mechanisms for information, consultation, negotiation, or financial participation?
2) Has the jurisdiction implemented international conventions and national norms that recognise the rights of employees to information, consultation and negotiation?

Sub-Principle VI.D.4.: Where stakeholders participate in the corporate governance process, they should have access to relevant, sufficient and reliable information on a timely and regular basis.

When the corporate governance framework allows stakeholders to participate, stakeholders should receive the information they need to effectively carry out their responsibilities.

Likely practices to be examined

Where laws and practice of corporate governance frameworks provide for participation by stakeholders, access to information is either mandated or is an accepted practice.

Essential criteria

1) In case of stakeholders' participation in the corporate governance process, is there any provision of sufficient and reliable information to facilitate their participation?
2) Where access is required, is there any recommendation or requirement to put in place effective mechanisms for enforcing such access as well as effective remedial mechanisms for those who are harmed by inadequate access?

Sub-Principle VI.D.5.: Stakeholders, including individual workers and their representative bodies, should be able to freely communicate their concerns about illegal or unethical practices to the board and/or to the competent public authorities, and their rights should not be compromised for doing this.

Relevant cross references to assess sub-Principle VI.D.5.:

Sub-Principle V.D.7., sub-Principle V.D.8.

Assessment of the sub-Principle should also be consistent with sub-Principle V.D.7. where the annotations indicate that "[…] In fulfilling its control oversight responsibilities it is important for the board to […] encourage the reporting of unethical/unlawful behaviour without fear of retribution. The existence of a company code of a publicly available company code of ethics should aid this process which should be underpinned by legal protection for the individuals concerned". The sub-Principle is also reflected in sub-Principle V.D.8., encouraging the establishment of appropriate control systems to underpin and ensure the integrity of the company's disclosure and its compliance with applicable laws and ethical codes, including those related to human rights, the environment, and work and safety conditions.

Likely practices to be examined

Individuals reporting unethical or illegal conduct often lose their jobs and find it difficult to find employment in other companies, which appear to wish to avoid "troublemakers". Redress is therefore important if the sub-Principle is to be considered as implemented. For the sub-Principle to be assessed as implemented it is not necessary that every complaint is directed immediately to the board but that it has established whistleblowing mechanisms under the supervision of someone independent on the board. In a number of companies, the point of access is often a member of the ethics or audit committee. Jurisdictions may as well bring cases of alleged violations to the National Contact Point (NCP) established for treating violations of the OECD Guidelines for Multinational Enterprises (OECD, 2023[2]).

Essential criteria

1) Are companies encouraging and permitting individual employees and their representative bodies to communicate confidentially their concerns about illegal or unethical practices to the board or its representative, to the competent public authorities and, where applicable, the NCP?
2) Does the legal and institutional framework provide for the protection of those who use the mechanism in good faith from any adverse responses that might be taken by the company?

Sub-Principle VI.D.6.: The exercise of the rights of bondholders of publicly traded companies should be facilitated.

Relevant cross references to assess sub-Principle VI.D.6.:
Sub-Principle VI.D.7.

The sub-Principle should be assessed in conjunction with sub-Principle VI.D.7., which recommends an effective and efficient insolvency framework and an effective enforcement of creditor rights.

Likely practices to be examined

The exercise of bondholder rights can be assured in many ways. First, bondholders may be represented by an independent bond trustee that reviews instances of covenant default and protects the interests of bondholders during debt restructuring. Also, institutional investors can be incentivised to exercise their right of bondholders in actively engaging with companies, for example through adhering to appropriate stewardship codes.

Another practice may include the adhesion to internationally recognised benchmarks for creditor rights and insolvency frameworks. Market initiatives may be useful to set standards and incentivise the use of enforceable and clearly defined covenants, avoiding adjustable financial metrics that may be modified at issuers' discretion.

Bondholders' participation in publicly traded companies' out-of-court debt restructuring should be facilitated.

Essential criteria

1) Does the jurisdiction have regulation applicable to bond trustees or typical contractual duties toward bondholders?
2) Are there initiatives in place to incentivise institutional investors to become more active as creditors and/or any self-regulatory standards for bond covenants?
3) Are there any initiatives to facilitate out-of-court debt restructuring, such as, for instance, guidance on how to apply insider trading rules during a debt restructuring or a system to simplify the identification of bondholders?

Sub-Principle VI.D.7.: The corporate governance framework should be complemented by an effective and efficient insolvency framework and by effective enforcement of creditor rights.

Relevant cross references to assess sub-Principle VI.D.7.:
Sub-Principle VI.D.6.

Companies are typically dependent for their operations on credit from various institutions such as suppliers and banks, using different financial instruments that vary according to the rights conferred on the creditors. The terms and conditions for the supply of credit are important for the continued operations of the company. The sub-Principle should be assessed in conjunction with sub-Principle VI.D.6., which encourages the exercise of the rights of bondholders of publicly traded companies.

Likely practices to be examined

The framework for corporate insolvency varies widely across countries although a reviewer can use as a benchmark the generally accepted international standards. Market participants such as banks, investors and credit rating agencies should be consulted about practices and how they deal with difficulties. The

Principles do not take a position on the appropriate balance between debtors and creditors in insolvency proceedings. This varies by jurisdiction and over time, and in some cases board members might even owe a fiduciary duty to creditors as a company nears insolvency. The reviewer is not called upon to make such a fundamental decision about the balance but to ensure that the system is effective (i.e. actually functions in a manner acceptable to market participants) and is efficient in the sense of incorporating the conflicting interests of both sides. The reviewer is referred for assistance in forming a judgement to widely used indicators as a guide, such as the time required for insolvency proceedings to be settled, the residual value of the final settlement and the relative role of debtors and creditors as opposed to insolvency administrators and/or the courts in the process. Where residual value is comparatively low, the time taken for the proceedings regarded by investors as inordinately long, and creditors only play an insignificant role, the sub-Principle should be assessed as partly implemented.

Creditor rights vary, ranging from secured bond holders to unsecured creditors. Effective enforcement of creditor rights is often reported as a key problem both for secured and unsecured creditors. Foreclosure can often be time consuming and expensive with collateral yielding considerably less than expected and for unsecured creditors the situation can be worse. The ease with which assets can be diverted from the debtor company prior to foreclosure should also form part of the assessment.

Essential criteria

1) Does the legal and institutional framework for treatment of insolvency: (a) clearly define the rights of different classes of creditors and allow them a constructive role in restructuring decisions to be taken by the insolvent company; and (b) include measures, mechanisms or incentives to minimise delay due to court and other procedures that may reduce the recovery value for creditors?
2) Are creditor rights enforceable without undue cost and uncertainty to the creditor?

References

IOSCO (2017), *Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation*, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD562.pdf. [1]

OECD (2023), *OECD Guidelines for Multinational Enterprises on Responsible Business Conduct*, OECD Publishing, Paris, https://doi.org/10.1787/81f92357-en. [2]

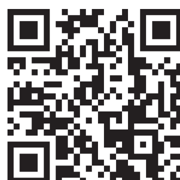
Notes

[1] See also Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation, Principle 25 (especially, but not limited to, Key Question 8). While the recommendations of IOSCO are likely to be relevant to an assessment of sub-Principle II.A.1. they are much more prescriptive than the Principles, specifying the mechanism to be used to obtain the objective.

[2] IOSCO Principle 36.

Methodology for Assessing the Implementation of the G20/OECD Principles of Corporate Governance

The Methodology for Assessing the Implementation of the G20/OECD Principles of Corporate Governance provides the basis for assessments of jurisdictions' implementation of the Principles. Together, the Methodology and the Principles provide guidance aimed at helping policy makers evaluate and improve their legal, regulatory and institutional framework for corporate governance with a view to promote market confidence and integrity, economic efficiency and financial stability. The Principles are the leading global standard for corporate governance and one of the Financial Stability Board's Key Standards for Sound Financial Systems. This version of the Methodology updates the 2017 edition and incorporates changes made to the Principles in 2023, and includes guidance for assessors.



PRINT ISBN 978-92-64-48683-6
PDF ISBN 978-92-64-93043-8