CGC UC
CENTRO DE GOBIERNO CORPORATIVO

Review to the OECD Principles of Corporate Governance

CGC UC Comments to the Public Consultation

Centro de Gobierno Corporativo UC (herein "CGC UC") encourages and welcome the revision of the OECD Principles of Corporate Governance (herein the "Principles"). CGC UC is a Chilean scientific interdisciplinary forum for the exchange of ideas and generation of knowledge on corporate governance matters. Its aim is to improve the role of corporate governance in public policies and strength management and responsible work in private and public entities, as well as non-profit organizations in Chile and Latin America. As an interfaculty centre, it is the result of a strategic partnership between the Faculty of Law and the Faculty of Economics and Administrative Sciences at Pontificia Universidad Catolica de Chile, due to which it operates as an association of both academic faculties.

CGC UC agrees with the necessity to adjust the current Principles in order to keep up with the ongoing developments in international markets and investments sectors. We believe that a good corporate governance framework should contribute to the long-term success of companies and efficient markets. Nowadays, the proliferation of corporate governance codes has permitted to rethink the role of key firm participants. Thereby, the Principles have been of much relevance and utility in the improvement and harmonization of best corporate practices and standards.

As follows, we suggest that the following issues should be taken into consideration for the new draft of Principles:

General Comments

- We welcome the recognition of the "comply or explain" principle based on market and companies particular circumstances. Being a worldwide public policy instrument, the Principles should emphasis a tailor-made approach based on the existence of diverging market realities and corporate governance frameworks worldwide. What is good for one company does not mean that is also good for another one. An effective corporate governance framework should be adapted to local market and business circumstances and overall coherently settled within its local normative framework.

- We support encouraging a mix of balanced company law, securities laws and self-regulation, under the form codes of conduct. In most jurisdictions, most fundamental topics, as the division of power between the board and the shareholders, minority shareholder protection, annual general meetings procedures, among others, are regulated under company law. Soft law regulation should asses

all policy measures that companies are recommended to implement for better performance. The effectiveness of such measures should be always accompanied with monitory measures. For emerging markets it is of great relevance to promote best corporate practices under the form of self-regulation in order to provide a flexible framework well adapted to their changing circumstances.

- We suggest that the Principles should address a preliminary introduction establishing the general values and recommendations supporting specific practices or recommendations. Companies should be guided to distinguish between main principles and particular recommendations. Companies should always consider main principles whereas specific practices should be well explained when deviated. Likewise, general values should be applicable to all type of entities i.e. listed companies, SOEs, closely held companies, non-profit organizations, middle market institutions, etc.

- Several countries are currently adapting their local corporate governance frameworks—as stated in the Principles—under the form of legislation, regulation, self-regulation, voluntary commitments or business practices. We believe that the guidance for the Principles should be specially promoted in first place to regulators and local authorities responsible of improving business practices in their own markets. Equally, individual companies should be encouraged to implement the Principles too. In such manner it will be easier to structure and harmonize specific best practices at domestic level.

Specific Comments

I. Ensuring the basis for an effective corporate governance framework

- CGC UC welcomes the recognition of the key role that stock exchanges play in the improvement of corporate governance. The regulation provided by stock markets is highly important. Stock exchanges should foster longer-term share ownership as a countervailing measure against short-term speculations. Recommendations on stock exchanges concerning companies' corporate governance should be frame under soft law regulation.

- The Principles should address the guidance for normative convergence concerning regional regulators. For instance, according to the Latin-American experience, the Alianza del Pacifico and MILA should be incentivize to avoid independent and diverging development of principles and likely opt for a common regulator model. More efforts should assess in avoiding double check regulation on common matters. It is key to address the harmonization of principles and regulation. We agree that a proper balance should pursue enforcement between private and public action.

However sanctioning powers should not be over emphasis. The effective balance will depend on the specific circumstances of each jurisdiction.

- We welcome the recommendation enhancing cross border cooperation. However the principles should not provide excessive attention to cross-border co-operation and exchange of information for the purposes of corporate governance-related enforcement. This topic should not be detailed addressed by the Principles. It is an institutional matter.

II. The rights and equitable treatment of shareholders and key ownership structures

- We welcome the guidance on related party transactions (RPTs). RPTs are one of the main issues concerning markets with concentrated ownership structures. Conflict of interests between majority and minority shareholders increases as no transparency on the ownership structure of companies with controlling shareholders is provided. This situation is of major relevance in countries essentially composed by company groups. As a reference, Latin America is dominated by controlling groups, often representing family interests with minority shareholders lacking access of sufficient information. Is recommendable to address RPTs under transparent and well-informed mechanisms.

- We believe that RPTs should not be approach under an illicit lens as always that the conditions for their conduction are clear and transparent enough for all parties, particularly for minority shareholders. Accordingly, we suggest that the Principles should clarify the criteria for "current and non-current transactions" typically advocated to RPTs. Accordingly the Principles should strength the obligation to report RPTs to the corresponding board committee and the public market as well. Alike, enhancing the role of independent directors and external auditors is a contribution to prevent abusive self-dealing from controlling shareholders.

- We estimate that issues concerning company groups should be strength. Issues related with equal treatment and protection of minority shareholders are inclined to occur within this type of business structures. Even though there are clear references in the Principles on company groups' activities it might be considerable to harmonize a clear guidance especially for company groups. The disclosure of capital structures required is a key matter. In the same way, changes in control.

- We believe that shareholders have a key role in approving remuneration policies concerning the board and top executives. However, we estimate that the Principles should not encourage the approval of "remuneration", instead of "remuneration policy". It must be noted that remuneration policies entail the total value of

compensation arrangements. There should be a right balance between the role of the board and the shareholders in terms of who is the best decision maker for corporate accountability over remuneration polices.

- Activist and active shareholders may play, together with institutional and qualified investors, key roles when strengthening corporate governance in different entities. However, companies should be protected against proposals and measures taken by such type of shareholders if aimed only to their personal benefit.

III. Institutional Investors, Stock Markets, and Other Intermediaries

- We welcome the guidance on institutional investors and their key role in promoting good corporate governance. Institutional investors are considered as a major force in many capital markets. Disclosure on voting policies, managing conflicts of interests and co-operation between investors are relevant aspects to take into account.

- We agree with the inclusion of other intermediaries (namely analysts, brokers and agency ratings) in the promotion of good corporate governance. Investment chains have lengthened, with too many intermediaries participating. As a result investee companies have increasingly distance from the beneficial owners. Thereby, the problem is that institutional investors are not willing to engage in monitoring corporate governance practices in investee companies.

- Institutional investors are key firm participants in markets with dispersed and also concentrated ownership structures. Where there is presence of strong controlling shareholders, institutional investors can provide an informed counterbalance of control against board and controlling shareholders self-dealing.

- From the OCDE countries, Chile has been a reference for the increasing power held by local institutional investors. With a concentrated market in the hands of dominant company groups, there are effective incentives to promote good corporate governance. With the support of minority shareholders, pension funds are able to nominate and elect independent directors. Cumulative voting is seen as an effective tool in promoting good corporate governance. Moreover there is a relevant economic interest for pension funds, as they can individually acquire up to 7% of the voting capital in companies.

- For most jurisdictions, a key major problem is that diversified portfolios cause market participants to restrain from voting in foreign portfolio companies. They accuse a lack of knowledge. On the other hand proxy advisors seems the most convenient solution, however there has been much debate on the influential power of proxy advisors on corporate governance.

- We estimate that the Principles should embrace the fact that institutional investors must be understood as a heterogeneous group in terms of objectives, strategies, time horizon, concentration and size. They certainly have different investment objectives and the Principles should not advocate any particular one. Precisely, too much over regulation might have some form of fiduciary duty, which is not the case. But what it is more accountability on the use of funds.

- We agree that for companies listed in multiple jurisdictions, the applicable corporate governance framework should be clearly disclosed.

IV. The Role of Stakeholders in Corporate Governance

- We believe that in promoting the success of the company and satisfying shareholders economic interests, the board must act on a long-term basis with regard (amongst other matters) to stakeholder relations. Corporate strategic decision should be guided in order to reach long-term sustainable value.

- We welcome the recognition of stakeholders in a manner to create wealth, jobs and sustainability of financially companies. However, and as part of this work, the Principles should also recognize that there must be an adequate balance between shareholder value and stakeholder value having profit maximization as a relevant part –obviously not the most important one- of the equation.

- The impact on stakeholders should be not advocated solely on sustainability and corporate social responsibility aspects. Further, risk management—meaning preventing or mitigating reputational, operational and financial risks-- is a key driver for engaging with stakeholders.

- As unfortunately corporate scandals are part of the corporate governance landscape, Principles should stress the importance of devices such as whistleblowers and hotlines to prevent or denounce improper situations.

V. Disclosure and Transparency

- We welcome the recommendation on timely disclosure of all material developments and the application of the concept of materiality. Information is also material when there is a substantial likelihood that a reasonable shareholder would consider it important in making an investment decision.

- In general, financial statements and annual reports are not investor-friendly. In practice, companies are valuated in terms of their financial results. Financial statements have been major drivers for market valuation. However, non-financial

aspects are equally relevant. Greater reporting on non-financial information is very welcome to better understand companies' risk and opportunities.

- We welcome the recommendation on non-financial information. A timely disclosure on non-financial aspects should be promoted when relevant for specific industries and circumstances. For example, some companies might well promote public policy commitments in consideration of their industries. Guidelines for non-financial aspects should encourage the incorporation of risk control mechanisms assessing the impact of operations concerning non-financial stakeholders' interests. It might be convenient to provide investors and public in general with non-financial information in a manner that is integrated with financial reporting too.

- We believe that a better guidance should be provided on "sustainability" or "integrated" reports. In practice companies are reporting with diverging standards. In such manner it might be recommended to include a standard reference framework for non-financial information. The idea is to avoid confusion between corporate social responsibility reporting, sustainability reporting and integrated reporting. It might be advisable to provide with a definition and content of integrated reports that could at the same time embrace sustainability information.

- We support disclosure on stakeholders' information as always that is considered as material information to the company's operational and financial performance.

- We agree with the recommendation on beneficial ownership disclosure. This is of special concern in countries where economic groups are the predominant form of corporate structure. Even more, investors should be detailed informed on the structures of pyramids schemes, viewed as common way of separating control from clash flow rights. Although, we believe that ownership disclosure should be provided when passing certain ownership thresholds.

VI. The Responsibility of the Board

- Policies regarding board evaluation, training and diversity are welcome within non-binding regulation. Imposing strict regulatory law is not necessary at all. Cross-appointment of directors among company groups is also another element that should be addressed.

- We support the recommendation on a transparent board nomination process and election process. The board has a key role in providing shareholders with candidates' profiles. Most relevant to take into account are candidates' skills, expertise and competence. Also, we welcome the recommendation for disclosure on board memberships to shareholders as a key instrument to improve board

nominations. However, any board nomination should take into consideration the existence of controlling shareholders and their property rights if the own a significant stake in the company and therefore their right to nominate and elect any person that they deem fit to the position in accordance with the level of investment in the company.

- We welcome the incorporation of risk management policies and procedures. Specialized committees, other than audit committees, are welcome for large companies. This is due regard to companies' size and risk profile.

- We agree on gender diversity but not under the form of rigid quotas.

- Directors working within the structure of company groups should guarantee their duty of loyalty to the company she or he serves and not to the wider interests of the group as stated in Principle VI.A. 104. This Principle is of quite relevance as the European Commission has into some extent supported the idea that transactions beneficial to the group but not in the direct interest of the subsidiaries can be considered as legitimate for directors under certain circumstances. Group defences have been applied in some European countries with concentrated ownership structures (France, Belgium and Italy). Accordingly, subsidiaries, especially those operating in emerging countries, can be subject of losses as the decline of the stock price coming from poor or self-interested decisions taken at the corporate level of the parent company. See examples of the German group governance model (Factual and Contractual Models) Following the Factual model applied in Germany, the negative impact of decision taken at the corporate level of the parent company should be disclosed, audited and compensated to the subsidiaries. More voluntary guidance should be provided by the Principles for controlling and subsidiaries company board members regarding responsibility of decisions taken a corporate level of the parent company in view of the wider interests of the group.

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