Report on Corporate Governance

Final Report

The Growth and Emerging Markets Committee
OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

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I. Executive Summary

In August 2015, the Growth and Emerging Markets ("GEM") Committee established a Corporate Governance Task Force ("CGTF"), comprising 16 GEM Committee members. The CGTF was chaired by Comissão de Valores Mobiliários ("CVM Brazil"). Financial Securities Commission ("FSC Jamaica"), Financial Services Board ("FSB South Africa") and Comisión Nacional Bancaria y de Valores ("CNBV Mexico") served as penholders, and benefitted from the additional review and support from the Securities Commission, Malaysia ("SC Malaysia").

The CGTF reviewed three key topics of corporate governance: board composition; remuneration and incentive structures; and risk management and internal controls. These topics were benchmarked against the G20/OECD Principles of Corporate Governance ("OECD Principles"). The rationale for choosing these three topics is explained in the Introduction.

At the end of 2015, the CGTF undertook a survey among GEM Committee members and relevant institutions and market entities to gather information on current corporate governance practices, and to identify priority areas for the consideration of GEM regulators moving forward. Eighty-two responses from over 30 jurisdictions were received from a cross-section of GEM regulators, stock exchanges, listed companies, corporate governance advocates, experts and academics.

Survey responses revealed a general alignment of GEM regulatory frameworks with the recommendations of the OECD Principles. There is also broad agreement on the direction regulators should take to: (i) improve the quality of boards, (ii) ensure that remuneration and incentive structures work to create long-term value rather than promoting excessively risky behavior; and (iii) improve risk management frameworks and internal controls within the corporate environment.

Following the 2015 revision of the G20/OECD Principles on Corporate Governance, the Corporate Governance Task Force Report ("Report") represents the first endeavor of capital markets regulators to identify and highlight measures and regulatory approaches that may assist emerging market regulators to strengthen corporate governance in their jurisdictions.

The Report is structured as follows:

Section II (Introduction) briefly presents the perspectives and background that led to the development of the Report, and explains the rationale for selecting the three corporate governance topics (board composition, remuneration and incentive structures, risk management and internal controls) and the manner in which the work was conducted. It also highlights some of the challenges caused by poor corporate governance practices that face capital market regulators in emerging markets, and analyzes recent progress achieved in corporate governance.

The Report then provides details of the three corporate governance topics in sequence. Sections III (board composition); IV (remuneration and incentive structures); and V (risk management and internal controls) are composed of three subsections each: (i) a brief description of the guidelines provided by the OECD (Subsection A); (ii) an analysis of the inputs provided by the entities that answered the CGTF Questionnaire (Subsection B); and (iii) resulting takeaways (Subsection C).

Board Composition

This section examines the critical role of the board of directors in any successful governance framework, reviewing the essential elements to promote board effectiveness, accountability and responsibility.

Highlighted is the need to ensure objectively independent board members through full disclosure of potential conflicts of interests, a critical mass of independent directors and the right mix and balance of skills, background and expertise that represent a wider range of perspectives.

It is critical for companies to ensure that board members undertake their responsibilities with the requisite diligence and spend an adequate amount of time preparing for board meetings. Finally, board quality can be assessed and further strengthened through the use of performance indicators' quantitative data, board evaluations and the nomination and selection processes.

The section further emphasizes that this process can be facilitated through the establishment of independent nomination subcommittees.

Remuneration and incentive Structures

This section deals with the questions of transparency and sustainability and its impact on incentive structures and remuneration schemes within the companies.

It discusses the need to better understand how both individual components of existing remuneration plans and variable criteria are linked to a company's short, mid and long-term goals. It also emphasizes the board's responsibility for assuring the alignment of key executive remuneration with the company's long-term performance and business continuity, and ensuring that the company is not exposed to undesirable risks in the name of immediate returns.

Risk Management and Internal Controls

This section aims to illustrate how regulators can promote effective implementation of internal controls systems and risk management policies by companies, mitigating internal and external risks that can trigger systemic consequences for capital markets. The following points are addressed:

Reliable disclosure by companies of material information concerning risk factors is critical and includes concise articulation of the main risks resulting from the risk identification methodology adopted and how they affect the business.

Companies should also provide quality reporting of sustainability, social and cyber risks. The disclosure of internal control systems and risk management policies should cover at least a description of the corporate control environment and how it promotes accuracy and high-quality financial and non-financial information. The efficiency and appropriateness of the companies' systems and controls should be periodically assessed, including identifying deficiencies and the appropriate corrective action to be taken.

As a part of this review, "real-life" issues are also discussed, such as the need for and practical difficulties of inculcating a risk-culture, in all levels of staff, and embedding compliance and risk management in daily business activities.

Conclusion

Finally, Section VI provides a brief overview of survey responses, highlighting the approaches to corporate governance adopted by emerging capital market regulators and reflects on possible future directions as a result of the key takeaways in previous sections.

Based on the suggestions and takeaways considered in the Report, the CGTF emphasizes that the Report represents more than a general diagnosis of the implementation status of the OECD Principles.

Therefore, it highlights that the work seeks to promote an effective debate among capital market regulators regarding the prominent role they could play within the context of the implementation and development of effective and coherent corporate governance structures.

In addition, given that the responses to the CGTF Questionnaire covered a wide range of issues, such inputs form an important additional source of data that can be used to develop complementary perspectives that may not have been directly addressed in the Report because of its more restricted scope.

II. Introduction

Background

During discussions, the GEM Committee of the International Organization of Securities Commissions ("IOSCO") concurred that the strengthening of corporate governance structures, particularly in GEM economies, is a critical issue for the sustainable growth in market based financing.

As a result, the GEM Committee agreed at its GEM Annual Meeting and Conference in Cairo, in April 2015, to have corporate governance as one of the three policy priorities to be undertaken by the Committee in the near future[1].

The GEM Committee established the CGTF in August 2015 to address key topics of corporate governance, identify common issues, needs and concerns among GEM Committee members, as well as share experiences in the implementation of corporate governance practices.

The revised G20/OECD Principles of Corporate Governance, released and endorsed by the G-20 in 2015, provides the framework for the development of this Report.

The Report is aimed at identifying practical ways to transpose the OECD Principles into regulatory measures. In other words, the main motivation guiding the development of this Report was the need to develop views on how best to deploy existing principles and standards in GEM capital markets from a regulatory perspective.

After all, capital markets regulators have to manage, on a regular basis, the practical implementation of corporate governance principles and standards, in order to have effective governance structures.

Participation in the CGTF was open to all IOSCO GEM Committee members. The CGTF working group was led by CVM Brazil, with the support of SC Malaysia, and made up by sixteen (16) GEM members[2]. FSC Jamaica, FSB South Africa and CNBV Mexico contributed as penholders. The CGTF focused its work on the following key topics:

- (i) Board composition, attributes, accountability and responsibility;
- (ii) Remuneration and incentive structures; and
- (iii) Risk management and internal controls.

The focus on these areas, especially in GEM jurisdictions, is explained by the following reasons.

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1 In addition to corporate governance, issues related to digitization and crisis management were also prioritized.

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

The differences in underlying capital market structures may lead to a divergence of philosophies and views regarding **the role of the board and its members and how they should behave**.

Globalization, however, shows that international sources of foreign investment are increasingly looking for a common set of standards and behavior, regardless of the underlying structures of capital markets. These common standards are reflected in the 2015 revision of the OECD Principles.

As a result, it is both critical and timely that the CGTF reviews GEM's corporate governance practices in light of the OECD Principles, taking into consideration the differences in GEM's underlying capital market structures.

Additionally, one of the key lessons learned from the global financial crisis is the importance of aligning **remuneration and incentive structures** with the creation of sustainable long-term shareholder value.

Incentives in many failed financial institutions rewarded top management for behavior that jeopardized or caused damage to the institutions for which they were responsible. It was observed that there was a need to ensure that the key performance indicators in the 'pay for performance' frameworks not merely set the right objectives to create long-term value, but also that the time horizons involved were appropriate. Failure to recognize the adverse impact of long tail risk or risk materializing after the end of an executive's contract encouraged excessive risk taking that negatively affected shareholder value in pursuit of short-term profits. In addition, as compensation has risen so dramatically in the last thirty years investors now seek to have a 'say on pay' and not leave this matter only is the board's hands.

The combination of the heightened need to ensure that remuneration and incentive structures lead to behavior aligned with shareholders' interest and the increased sensitivity regarding the compensation makes this a topic of interest.

Finally, another lesson from the global financial crisis was that regulators and boards needed to reinforce and prioritize **risk management** in their agenda, with a wider approach to normal micro-prudential risks relating to individual companies and paying more attention to macro-prudential risk **(**i.e. systemic risks) events as well.

In November 2015 the CGTF circulated a questionnaire ("CGTF Questionnaire") to all GEM members and relevant entities and stakeholders. The CGTF Questionnaire covered the three areas above mentioned. It was designed to gather information on the state of corporate governance practices and approaches in GEM jurisdictions, and collect the views of regulators and relevant market participants.

The CGTF received 82 responses[3] from regulators, market entities, stock exchanges, think tanks, companies, institutional investors and other stakeholders, in more than 30 jurisdictions, providing diversified and valuable inputs to the development of the work[4].

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[3] The list of responding entities is attached at the end of this Report. Please note that some respondents expressly requested a reserve treatment of their responses and are not mentioned either in the Report or

The diversity of input was valuable to the development of this Report, and instrumental in highlighting the differences in approaches and experiences in promoting good corporate governance in GEM jurisdictions.

Based on the views and experiences provided by GEM jurisdictions surveyed and relevant entities and stakeholders, the Report identifies priority issues for each of the focus areas and suggests approaches for future consideration in order to raise the bar regarding the implementation of best corporate governance practices.

The CGTF has no intention to impose responsibilities for capital market regulators in terms of assessing the implementation of internationally accepted corporate governance standards, but it acknowledges that regulators can play a relevant role in this regard.

The Report aims to provide elements and insights that might constitute a common basis and, where applicable, signal possible alternatives for capital markets regulators in GEM jurisdictions to promote corporate governance best practices.

Overview

Although corporate governance is an idea that dates back as far as the early trading days, corporate governance frameworks are still fairly recent and the first codes of best practices emerged only in the 1990s, focusing on the role of the board and on internal governance structures to protect shareholders' rights and corporations.

The development of formal codes and frameworks was triggered by the occurrence of a number of corporate accounting scandals that adversely impacted capital markets across the globe during that decade. These cases raised major questions concerning their causes and effects, compelling the corporate environment to reconsider many of its principles and practices.

A review of the facts showed that poor decision making processes, often supported by wrong incentives and fragile internal control systems. Cases of misconduct were not the only cause.

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in the attached list. In addition, there are some regulators and entities that, although they have not formally answered the CGTF Questionnaire, have contributed to its review, as referred in the footnote below.

[4] These inputs included recent and concrete examples of both positive experiences as well as cases that deviate from corporate governance best practices, allowing CGTF members to have a broad and comprehensive picture of the status, thinking and common challenges that affect GEM jurisdictions, particularly regarding the sensitive topics addressed in this Report. This circumstance has increased the array of perspectives, but also represented a challenge when trying to reflect the accurate position of a specific jurisdiction towards its regulatory framework, since some responses were not consistent among entities and regulators of the same jurisdiction. Finally, it is worth mentioning that the Report also reflects inputs and comments provided by key entities and agents, such as the Capital Markets Authority of Kuwait ("CMA Kuwait"), the Corporate Governance Team of the World Bank ("World Bank"), the International Corporate Governance Network ("ICGN"), the Certified Financial Analyst Institute ("CFAI") and Ms. Maria Helena Pettersson, member of the Public Interest Oversight Board – PIOB.

There was also a cultural atmosphere where risk management was not regarded as a high priority, impacting the stability of markets as a result.

Since then, the debates on corporate governance have evolved significantly, raising awareness that inappropriate decisions (or even decisions that have been taken in the interests of controlling shareholders), as well as deficient internal risk control procedures, could result in significant losses in the long run, endangering business continuity and market sustainability.

Sound and well implemented practices of corporate governance do give rise to a more transparent, sustainable and responsible business environment, allowing a more equitable treatment of shareholders, timely and accurate disclosure of relevant corporate information, professional, qualified and accountable management, as well as adequate identification, measurement and control of risks.

Implementing these practices to ensure the alignment of interests for sustainable businesses creates value for companies and facilitates access to capital, by boosting investor confidence and encouraging investors to make long term decisions. This can only be achieved if corporate governance structures include clear and transparent disclosure regimes, and encourage accountability, ethical leadership and corporate citizenship. These structures need to remain relevant over time to meet new societal demands and ensure capital markets perform their role effectively in terms of sustaining economic growth.

The maintenance and development of effective corporate governance structures has become a worldwide concern, and it is increasingly regarded as one of the key factors to strengthen capital markets.

Global debates over the last decades have led to the development of robust international benchmarks in corporate governance, which have also been driven by, among others, active engagement between capital market regulators and market entities and agents. These standards, based on common elements underlying a strong governance framework, constitute a robust, but flexible reference for policy makers and market participants. They are now reflected in the legal and regulatory framework and in voluntary practices adopted in several jurisdictions.

As one of the main global standard-setters in this matter, the OECD highlights the fact that the desirable corporate governance framework in any country is a mix of legislation, regulation, self-regulation and voluntary standards based on the country's specific circumstances, history and tradition. The OECD Principles are therefore intended to provide a general guide of best practices, to be applied as the particular circumstances of any country permit[5].

There is a prevailing view that corporate governance should be a key priority on the agenda of capital market regulators, who have taken an increasingly prominent role in encouraging

[5] Consequently, the OECD Principles encourage policy makers to put in place a framework flexible enough to meet the needs of corporations in widely different circumstances, while bearing in mind the ultimate aim of supporting economic efficiency, sustainable growth and financial stability.

the adoption and implementation of corporate governance standards and best practices, complemented by effective enforcement.

Nonetheless, despite all the progress, there is still a significant number of malpractices and corporate governance failures, as illustrated by answers provided by respondents to the CGTF Questionnaire. Survey respondents reported material poor experiences and misconduct which could have been avoided or mitigated through better governance practices. The survey results provided examples of cases and situations of poor governance that affected stakeholders' rights, investor confidence or even created potentially systemic risks.

Some common concerns and challenges within emerging markets can be identified, as follows:

i) Abusive related party transactions

Events involving improper transactions with related parties, featuring breaches of board fiduciary duties, conflicts of interests or poor disclosure practices[6] were reported by *CNV Argentina*, *CMB Turkey*, *UAE Hawkamah*, *Corporate Governance Centre of the Catholic University of Chile*, *T. Rowe Price* and *Aberdeen Asset Management*.

ii) Disclosure failures

Failure to disclose material information was also reported by several respondents to be a general concern[7], covering different cases such as:

(i) non-issuance of financial statements within the legal deadline[8];

(ii) misconduct in information disclosure[9];

(iii) announcement, by a CEO, of financial results prior to the official publication of financial reports[10];

(iv) non-compliance with regulatory requirements for corporate records[11]; and

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6 CNV Argentina pointed out, as an example of poor compliance, cases in which directors and auditors did not notify relevant events, such as transactions with related parties. CMB Turkey indicated the lack of disclosure of related party transactions as one of its main concerns. UAE Hawkamah cited the existence of many cases of conflict of interests at the board level. Corporate Governance Centre of the Catholic University of Chile, on the other hand, described a concrete case in which SVS Chile sanctioned the directors of a Chilean power company who breached their duty of care when evaluating a transaction with the parent company, failing to take the appropriate steps to ensure equitable conditions. Lastly, T. Rowe Price and Aberdeen mentioned the acquisition of a Brazilian company by the French parent company where the conflicted party was permitted to vote.

7 SSC Vietnam.

8 HANFA Croatia reported that a number of issuers did not publish their financial statements for the third quarter of 2015 within the legal deadline.

9 CSRC China reported two enforcement proceedings conducted in view of misconduct on information disclosure, which were allowed, respectively, by pro forma acting of the board of supervisors and of independent directors who did not fulfill their duties of diligence.

10 HANFA Croatia

11 Argentina BBVA and Bursa Malaysia.

(iv) misleading information and false prospective data[12].

iii) Corruption scandals and undue political interference in state-owned enterprises (SOEs)
Other points of concern, shared by some jurisdictions, relate to **state-owned enterprises (SOEs)**, which account for a significant part of market capitalization in most of the GEM jurisdictions[13].

As a means of illustration, *FSB South Africa* mentioned a case of gross financial mismanagement in a South African state-owned transportation company, characterized by mismanagement, corruption, conflicts of interest and nepotism. In addition, the crisis of Brazil's largest state-owned oil and gas company was cited by *ICGN*, *T. Rowe Price*, *Brazil AMEC*, *Brazil ABRASCA* and *Brazil BM&FBOVESPA*.

Several examples of fiduciary breaches, **corruption, and undue political interference** in SOEs raised questions about what the position of regulators on this matter should be, for instance in applying differentiated corporate governance requirements or levels of compliance by SOEs.

Although there is no uniform view concerning the establishment of differentiated requirements or level of compliance, the answers to the CGTF Questionnaire reveal some concrete measures and recommendations in place to enhance controls and avoid improper government interventions in SOEs[14].

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12 A Brazilian emblematic case was cited by Brazil ABRASCA and Brazil BM&FBOVESPA, involving a corporate group with operation in several segments (as oil and gas, shipbuilding, energy, mining, logistic), which was affected by a devastating crisis triggered, in accordance with market analysts, by failure to disclose material information, related parties transactions and personal influence of the controlling shareholder in management issues. The events led to several enforcement proceedings conducted by CVM Brazil, with charges that included a lack of timely disclosure, breach of fiduciary duties by the board and executive directors, accounting infringements, controlling shareholder abuses and market manipulation. Additionally, SVS Chile reported two concrete cases in which the financial situation of companies was hidden due to lack of timely disclosure.

13 On this matter, please also refer to OECD Guidelines on Corporate Governance of State-Owned Enterprises, also revised in 2015.

14 Fifteen (15) out of thirty (30) regulators (Argentina, Chinese Taipei, Croatia, Dominican Republic, Israel, Mauritius, Pakistan, Romania, Russia, Saudi Arabia, South Korea, Thailand, Tunisia, Turkey and Vietnam) that answered to the CGTF Questionnaire have indicated that listed SOEs should be subject to differentiated corporate governance requirements or levels of compliance, while four (4) of them stated that this was not applicable (N/A) since those companies were not listed (Angola, Mexico, Panama) or considered to be part of the financial market (El Salvador). Eleven (11) regulators stated that SOEs should not be submitted to those differentiated requirements (Bangladesh, Brazil, China, Egypt, India, Hungary, Kuwait, Poland, South Africa, Trinidad & Tobago and UAE).

Measures and recommendations in place, as applicable to SOEs, includes the following: (i) requirements of share ownership dispersion; (ii) business strategic decisions should be taken in the shareholders meetings; (iii) the government should avoid interfering in the day to day management of the SOEs; (iv) SOEs should be required to appoint independent directors; (v) Government should lower quickly its stake in listed SOEs; (vi) SOEs should be differentiated from other governmental bodies, and the board should be permitted to interfere only in strategic decisions; (vii) full transparency on strategic decisions, related-party transactions and audited financial information; (viii) setting up fit and proper criteria for nomination and appointment of directors and key management staff; and (ix) mandating a majority of independent directors via legislation/regulation.

From *SEC Thailand*'s perspective, listed SOEs should still follow similar guidelines as the listed companies in general. However, there should be additional requirements to address certain issues (i.e. the role of governments and their intervention in SOEs, independence of the board from government influence, conflicts of interest, and corruption) that may not result in the best interest of the stakeholders.

In this regard, it is also worth highlighting that the Brazilian Congress approved, in 2016, a General Law of SOEs[15]. In the wake of the 2015 SOEs Governance Program proposed by *BM&FBOVESPA* (Brazilian Stock Exchange), the new law stipulates, among other provisions, specific corporate governance requirements, particularly with respect to transparency[16], internal controls[17] and board and management composition (e.g., the nomination to management positions of certain agents, such as congressmen and leaders of political parties, will be prohibited[18].

The answers to the CGTF Questionnaire reveal a wide range of infringements, misconduct and structural fragilities that could be avoided, or at least mitigated, with better governance practices related to the **three focus areas addressed by CGTF**.

The outcomes of the survey reinforce these three focus areas as essential for market integrity, efficiency and sustainability:

(i) an independent, qualified and accountable board of directors, with clear priorities and responsibilities[19];

(ii) transparent and proper remuneration structures[20]; and

As can be observed, the large majority of measures are deeply related to board qualification and independence, which can be accomplished by the establishment of transparent decision-making processes, by setting up fit and proper criteria for board members, as well as by the presence of a minimum number of independent directors.

15 Brazilian Federal Law No. 13,303/2016.

16 For instance, an annual report disclosing objectives related to the fulfillment of public policies, as well as operational and financial data deriving from such policies.

17 Internal audit and audit committee.

18 By the time this Report was circulated, the law had not been sanctioned by the President yet.

19 Governance failures arising from a **lack of a truly independent board performance** were pointed out by CMB Turkey and SEC Bangladesh, which, in addition, has also stressed poor compliance related to the required independence and effectiveness of audit committees. From another perspective, CSRC China noted a concrete case in which two independent directors of a company were warned and fined for not taking appropriate and diligent measures to prevent misconduct of information disclosure.

Poor qualification of board members, in its turn, was referred to by Oman Centre for Governance and Sustainability as a material example of governance failure. FPLC Malaysia also pointed out that the grassroot problems in corporate governance failures are people. Brazil AMEC highlighted the **accountability of directors as a common problem** in most cases that generate losses to investors.

Lastly, with respect to **improper delegation of board attributions**, CMA Saudi Arabia noted a case in which the board, in contrast to best governance standards, delegated to the audit committee its responsibility for approving corporate financial statements.

(iii) effective internal controls and risk management policies[21].

The following sections are intended to provide a reference to GEM regulators with views, practices and examples of initiatives to translate corporate governance principles into practice. The sections look briefly at the relevant OECD Principles, consider the findings of the survey, and suggest key takeaways for future consideration by capital market regulators.

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20 SEC Trinidad and Tobago reported a concrete case in which a senior risk manager of a company was able to purchase a relevant amount of shares from the employee allotment and resell these shares shortly after an IPO, making significant profits on the deal.

21 As a general note, ICGN pointed out that a weak corporate culture and poor risk management are the main concerns related to capital markets safety. Dubai FSA reported an enforcement proceeding in which the regulatory entity took action in virtue of breaches of fiduciary duties and contraventions with several requirements regarding internal systems and controls to prevent money laundering and other infringements. SEC Trinidad and Tobago, in its turn, narrated a concrete case in which risk management was impaired in virtue of the inappropriate selection of an external auditor, who had a clear conflict of interest, and neither raised significant risk areas nor identified existent weaknesses in the corporate compliance program. SEC Thailand reported its proceedings against an executive director and one member of the board for not following the internal control policy and procedures of their financial institutions -- approving a significant loan to a subsidiary of a company, while being aware of the subsidiary's inability to pay back the loan and the subsidiary's insolvency.

III. BOARD COMPOSITION

The board is universally regarded as the key corporate body within the governance framework, although its definition may cover different structures, attributes and operational procedures. The board has an important mandate in terms of pursuing strategic objectives that advance the interests of stakeholders.

As a result, corporate governance standards and frameworks have paid significant attention to the role of the board within corporate structures. The board is recognized as the main link between a company's shareholders and its management. It is accountable for a company's performance and is responsible for providing strategic guidance, management oversight and setting goals, policies and systems to safeguard shareholders' rights, business continuity and compliance with applicable laws and regulation.

If the board is to be truly accountable for a company's performance and answerable to shareholders, then the composition of the composition and its effectiveness are two key concerns. Ensuring that board members have the right skills and the proper level of commitment and independence, reinforced by the use of performance evaluation tools, has proved to be the basis for a sound and successful corporate governance framework.

The global financial crisis showed that in some of the worst affected institutions, boards were comprised of members with limited understanding of the rapidly increasing complexity of the institutions they were leading and, consequently, they were unwilling or unable to provide the constructive independent challenge needed to prevent their organizations from making grave errors of strategy. Further, many boards lacked appropriate structures, such as risk and audit committees, that allowed members to challenge management's approach to risk. Nor did they have the means to ensure that board decisions and policies were effectively put in place.

As a result, the CGTF focused on key issues that have an impact on the effectiveness of the board's performance. The CGTF also focused on the role of regulators in ensuring that members of the board are properly qualified and committed, and that they are supported by the appropriate structures to function effectively.

A. Relevant OECD Principles

Chapter VI of the OECD Principles outlines the essence of board responsibilities, highlighting the duties with which board members must comply when performing their key functions.

In this regard, Chapter VI states that board members are required to apply **high ethical standards** (Principle C[22]) and act diligently, in **good faith**[23], and on a **fully informed basis**

22 Chapter VI, Principle C: "The board should apply high ethical standards. It should take into account the interests of stakeholders".

23 Duties of care and loyalty are highlighted as the key components of board fiduciary duties. At this point, the OECD points out the different perspectives the definitions of care and loyalty may comprise. Therein, the OECD states the standard of duty of care might be understood as "*the behaviour that a*

(Principle A[24]), accessing accurate, relevant and timely information to support their decision-making process[25].

These elements are tied to the Principle E, according to which the board should be able to exercise **objective independent judgment** on corporate affairs[26]. The fulfillment of this principle promotes an adequate exercise of board duties, such as monitoring managerial performance, and preventing conflicts of interest[27], but it also has several implications for board structure and composition.

Board composition is also approached by the OECD in Item 4 of Principle E, which expressly refers to the importance of "*the right mix of background and competences*" in order to promote diversity of perspectives and thinking[28].

The OECD Principles also assert that the board, based on the company's size, characteristics, risk profile, and local requirements and recommendations, as well, should consider the

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reasonably prudent person would exercise in similar circumstances". Loyalty, on the other hand, is deemed as a duty of central importance, rooted in the implementation of other principles, as monitoring of related party transactions, definition of compensation policies and in the needed equitable treatment of shareholders.

24 Chapter VI, Principle A: "Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders".

25 Chapter VI, Principle F: "In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information".

26 The principles recognize that the way board objectivity might be encouraged may vary depending on the jurisdiction's practices or corporate ownership structure, highlighting, however, that board members, in all cases, have fiduciary responsibilities to the company and all shareholders. Following, the OECD states that board independence usually requires that a sufficient number of board members be independent from the management. This being established, the OECD Principles recommend some means of setting board independence, including: (i) a sufficient number of members not employed by the company or its affiliates; (ii) a sufficient number of members not closely related to the company or its management through significant economic, family or other ties; (iii) where there is a party in a special position to influence the company, stringent tests to ensure the board's objective judgment; (iv) inclusion, in corporate governance codes, of positive examples related to qualities that will increase the probability of effective independence; and (v) a declaration of the board regarding which members they consider to be independent, and the criteria for this judgment.

27 Chapter VI, Principle E, Item 1: "*Boards should consider assigning a sufficient number of nonexecutive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are ensuring the integrity of financial and non-financial reporting, the review of related party transactions, nomination of board members and key executives, and board remuneration*".

28 Additionally, the OECD indicates some measures to be considered by jurisdictions in this regard, including "*voluntary targets, disclosure requirements, boardroom quotas, and private initiatives that enhance gender diversity*". This issue was submitted to the entities that answered the CGTF Questionnaire.

The above mentioned Item 4 also emphasizes that, in order to improve board practices and performance, board members should be subjected to (i) training (in-house and external courses), keeping pace with relevant new norms, commercial changes or emerging risks and (ii) regular evaluation, with proper criteria and goals, meeting company needs. In large companies, this appraisal is recommended to be supported by external facilitators.

establishment of specialized committees, of a supporting and not substitutive nature, regarding core issues, as audit, risk management, nomination and remuneration[29].

The OECD highlights, in Principle D, the **key functions** that should be performed by the board. This nucleus comprises the following activities:

(i) **strategic guidance** of the company, including monitoring of **performance**, establishment of **objectives** and implementation of **risk policies and internal systems**;

(ii) **proper assessment and disclosure of corporate governance practices and internal structure**, ensuring clear lines of accountability;

(iii) **selection, compensation, monitoring** and, if needed, replacement of **key executives**;

(iv) **alignment of key executive and board remuneration with long-term goals** and value creation objectives;

(v) establishment of a **formal and transparent board nomination and election process**;

(vi) **management of potential conflicts of interest** and misconducts;

(vii) **establishment of internal controls**, ensuring **integrity of corporation's accounting and financial** reporting, proper **risk management** and **compliance**; and

(viii) **oversight of disclosure process** and communication, with clear establishment of due functions and responsibilities.

B. Analysis of survey results

GEM jurisdictions and relevant entities were invited to provide their views on topical issues relating to board effectiveness, when measured against the standards set by the OECD regarding board composition, its key responsibilities and fiduciary duties of board members. Information provided by respondents to the CGTF Questionnaire provides emerging market regulators with a better understanding of how they should encourage an accountable, responsible and efficient performance of the board of directors and its members.

b.1) Director Independence

For many years, regulatory initiatives have been focused on enhancing the independence of directors. Independent directors were viewed as a solution for balancing influence and conflict of interest, while strengthening the effectiveness, accountability and performance of

[29] Chapter VI, Principle E, Item 2. These committees, which duties, composition and working procedures must be defined and disclosed by the board, may significantly contribute to board decision-making process, benefiting its performance in key functions.

boards, particularly in the aftermath of financial crisis, triggered by major collapses of global conglomerates and other financial institutions[30]. Following the global financial crisis, several regulatory measures were introduced, establishing, on the one hand, criteria for defining what is meant by independence and, on the other hand, determining the minimum number of independent directors seated on the board.

Jurisdictions continue to refine what constitutes *independence* through various measures, including establishing criteria for independence, procedures for the election of independent directors and specifying the minimum number of independent directors that should be on boards.

Some jurisdictions have been seeking to strengthen the independence of directors through professional accreditation program to qualify directors to sit on boards, followed by continuous professional development to ensure they stay abreast of the latest issues and developments. This is done to educate independent directors about their roles and duties, thereby arming them with the confidence and capacity to provide the independent and constructive criticism that is essential for building an effective mechanism of internal "checks and balances"[31].

The general agreement about the importance of ensuring director independence is evidenced by the survey's results, which revealed that **only two respondents**[32] **stated that there were no regulatory provisions in place to establish independent board members**[33]. It is therefore clear that there is an agreement in principle on the need for independent directors to carry out their oversight function effectively by being able to challenge the nature and quality of decisions taken by executive directors.

In this context, two main issues need to be considered: (i) the concept of "*independence*" itself; and (ii) the ability of directors to provide constructive criticism, without being divisive.

Concept of independence

As a concept, independence has been primarily defined and assessed as the economic relationship between independent directors and the companies on whose boards they serve, or with other relevant shareholders.

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30 Cases in point include Maxwell Communications PLC in the United Kingdom and WorldCom and Enron Corporation in the United States.

31 FSC Chinese Taipei expressed that "[i]ndependent directors help strengthen board functions and corporate management" and that "[t]he establishment of independent directors is a better governance mechanism for building an effective internal check and balances systems." Likewise, SEC Pakistan emphasized that regulators should address the issue of independent directors as a tool to secure good corporate governance by "creating awareness about the positive role independent directors can play on boards, and by managing pool of such professionals which can act as independent directors on companies' boards." HANFA Croatia and Corporate Governance and Capital Market Centre of the University of Chile, on the other hand, suggested that regulators can play a role by encouraging awareness regarding the accountability of independent board members.

32 SSF El Salvador and NBFIRA Botswana.

33 NBFIRA Botswana revealed the absence of regulatory provisions in this regard, but mentioned this issue was under review.

In 2007, the IOSCO produced a report on Board Independence of Listed Companies[34], defining independence based essentially on (i) negative criteria and (ii) positive attributes.

Negative criteria stated by IOSCO indicated **that an independent director should not**:

(i) be a member, or an immediate family member of a member, of the management of the company;

(ii) be an employee of the company or group;

(iii) receive any other compensation from the company or group[35];

(iv) have material business relations with the company or group;

(v) have been an employee of the external auditor of the company or group;

(vi) exceed some maximum tenure as a board member; and

(vii) be or represent a significant shareholder.

Positive attributes include having:

(i) an adequate professional background;

(ii) the ability to furnish experience and knowledge in furtherance of the company;

(iii) integrity and highest ethical standards;

(iv) sound judgment and inquiring mind; and

(v) constructive questioning, contributing to the strategy's implementation[36].

Negative criteria may roughly be defined as the absence of any material conflict of interest. As pointed out by ICGN, it is "*a director's ability to exercise judgment free of external influence*"[37].

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[34] Available on https://www.iosco.org/library/pubdocs/pdf/IOSCOPD238.pdf

[35] Beyond directorship fees.

[36] Among the positive attributes expected to be fulfilled by independent directors, SEBI India reported some aspects of the definition of independence in their jurisdiction, which encompass the board's evaluation regarding the integrity, relevant expertise and experience of the individual (who must not be less than 21 years of age). Similarly, SEC Thailand also reported that Thai Institute of Directors recommends that companies consider the following characteristics when selecting a director, (i) integrity and accountability, (ii) ability to utilize informed judgment, (iii) being a prudent and mature person and a good listener to advance constructive debates and independent opinions and (iv) a person of principles and professions.

[37] Definitions of independence provided by respondents to the CGTF Questionnaire demonstrate, in essence, an alignment with these **negative criteria**. In this sense, for instance, CSRC China defines as some of the individuals who cannot serve as independent directors: (i) employees of the company and its subsidiaries, as well as employees' immediate family members and major social relations; (ii)

As reported by *CNBV Mexico* and *SC Malaysia*, independent board members should be able to carry out their functions and responsibilities without being subject to any personal, patrimonial or economic interest, but should also meet required *positive attributes*, as they should be chosen based on their expertise, technical skills and acknowledged professional background[38].

It is the inclusion of positive attributes in the independence criteria that will truly enable independent directors to constructively challenge decisions proposed by other board members and contribute in meaningful ways to the strategic objectives and stewardship of companies.

As the initiatives vary across jurisdictions, it may be difficult to identify a common theme, but the survey's responses highlighted issues that go beyond the definition of independence.

Need for critical mass of independent directors
Institutional investors that responded to the CGTF Questionnaire highlighted the need for a **critical mass of independent directors**, with at least **one third of board members being independent** in order to make effective their performance[39-40]. This view is shared by several GEM regulators, which reinforces the need for an appropriate number of independent directors on the board, achieved through requirements and recommendations[41-42].

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people with significant equity participation (more than 1% or among top ten shareholders); (iii) people who provide financial, legal, consulting or any other related services to the company. Dubai FSA, for its part , suggests that the assessment of independence against such criteria should consider whether the individual: (i) had previous jobs in the company or group; (ii) has or had material business relationships; (iii) receives or has received additional remuneration from the company; (iv) has close family ties with entities' advisors, directors or senior employees; (v) holds cross directorships or significant links with other directors through involvement in other companies or bodies; or (vi) represents a significant shareholder. SEBI India, MNB Hungary, CNBV Mexico, SEC Thailand and Bursa Malaysia also described their independence criteria, fundamentally on the same core elements, with SEC Thailand further requiring the director not to undertake any business in the same nature and in competition of the business of the applicant or the subsidiary company.

38 *CNBV Mexico* highlighted that independent board members should not be subject to any personal, patrimonial or economic influence, and should also meet required <u>positive attributes</u>, as they should be chosen due to expertise, technical skills and acknowledged professional background. In accordance with the Listing Requirements of *Bursa Malaysia*, the board has to give effect to the spirit, intention and purpose of the independence definition. In other words, even if a person apparently satisfies said definition, the director concerned as well as the board must still apply a subjective or qualitative test of whether the said director is able to exercise independent judgment and act in the best interest of the company.

39 ICGN, T. Rowe Price, Aberdeen, Bursa Malaysia, MSWG and Kasturi Nathan.

40 Brazil AMEC also cited that, in the context of companies governed by shareholders agreements that mandate how a majority of directors should vote, independent board members would not be effective.

41 The 1/3 criterion was the most recurrent citation, referred by SC Malaysia, CSRC China, SSC Vietnam, CMA Saudi Arabia, SEC Thailand and CMB Turkey as mandatory requirements. According to SEC Thailand, furthermore, the regulator should also consider the size of the board whether such proportion would enable independent directors to fully express their opinions. Russian Corporate Governance Code also prescribes recommendations in this sense. CNBV Mexico, in its turn, requires listed companies to have at least ¼ of independent board members. In Bangladesh and the Dominican Republic, regulatory frameworks demand a minimum 1/5 of independent board members. In Chinese Taipei, public companies are required to appoint independent directors, <u>no less than two in number and no less than one-fifth of the total number of directors</u> pursuant to Article 14-2 of Securities and

Appropriate balance between executive and non-executive members

Another factor contributing to the effectiveness of the board, raised by several respondents, is the need to get the right balance between executive (*managing*) and non-executive (*supervisory*) directors[43].

The most common regulatory approaches and measures concerning the board and subcommittees' composition to promote an independent board performance, include:

(i) board chaired by an independent non-executive chairman, who should not be the CEO[44];

(ii) audit committees composed of independent non-executive directors;

(iii) nomination committees composed of board chairman and non-executive directors (the majority of whom are independent); and

(iv) remuneration committees composed of non-executive directors (of which the majority should be independent)[45].

The survey's results suggest that there is a general alignment in the regulatory frameworks of GEM jurisdictions with internationally accepted standards regarding the definition of independence. However, when it comes to fostering effective independence of mind in board members, it goes beyond outlining the independence criteria, and regulators need to act in complementary fronts. There are a number of practical barriers which can make it difficult for independent directors to challenge constructively, for example:

(i) **Positional authority** of the chairman or CEO in so called 'high power distance' cultures, preventing board members from challenging the chairman or the CEO, who expects to be deferred to and agreed with as a matter of culture;

Exchange Act. SEC Pakistan, SMV Panama and SVS Chile require at least one independent board member (Chilean law also requires companies that (i) have high equity assets or (ii) ownership distributed among a significant number of shareholders to establish a committee of directors, mostly independent and with functions and duties similar to audit and remuneration subcommittees). MNB Hungary reported that the Hungarian Civil Code requires the majority of the members of the Board of Supervisors (also fulfilling the functions of the Supervisory Board) to be independent (except when the company is part of a group). Finally, SEC Trinidad and Tobago reported recommendations in place aiming at a board composed mostly of independent directors.

42 Nonetheless, this reference may not be applicable to all jurisdictions, as legal and regulatory regimes vary among jurisdictions. As an example, in accordance with CNBV Mexico, the Mexican Securities Market Law provides that 25% of board members should be independent members.

43 This approach was reported by FSB South Africa, Dubai FSA, SEBI India, FSC Mauritius, CMB Turkey and FSA Romania.

44 This measure might be difficult to be implemented in markets with high concentration of ownership.

45 In Kuwait, CMA corporate governance rules encourage the subcommittees (remuneration, nomination and audit committees) to be composed of at least one independent member, chaired by a non-executive director; which, in the case of audit committees, should not be the chairman of the board.

(ii) **Personal authority** of charismatic, successful and domineering CEOs;

(iii) **Asymmetry of information** that independent non-executive directors receive from management and their resulting lack of granular understanding of the business model and its drivers, depriving independent directors of either the confidence to challenge executives or, having done so, their ability to evaluate properly the answers given to them; and

(iv) **Great value placed on harmony in some cultures**, making it difficult for board members to express divergent points of view.

In this sense, *SEC Thailand* suggested that the focus of the regulator should be oriented towards creating buy-in from the shareholders on having corporate governance in substance rather than solely depending on independent directors.

Apart from measures to avoid conflicting decisions, the induction, training and, eventually, formal certification of board members and management should also be considered as relevant measures[46]. These measures have the potential to foster greater accountability and more effective competencies[47], in order to ensure board members have proper knowledge of the company's uniqueness, commercial changes and emerging risks.

Table III.B.1. Summary of responses on board independence:

Survey results indicate a clear need to foster the objective, independent judgment of boards. **Possible regulatory approaches drawn from the survey include:** **(i) promoting awareness of the accountability and required competences of board members, including instituting long-term training and continuous development program for members;** **(ii) focusing on material transparency requirements concerning aspects that might potentially skew board decisions or lead to conflicts of interest and abusive related party transactions; and** **(iii) promoting structures and requirements that allow board members to challenge decisions effectively, including: (a) defining positive characteristics and qualification of members, (b) stipulating a minimum number of independent directors (one third may be a good reference) and/or (c) achieving an adequate balance of executive and non-executive directors**.

b.2) Diversity

46 In Thailand, directors are recommended by the Stock Exchange of Thailand to attend training provided by the Thailand Institute of Directors.

47 These criteria should be properly linked to board evaluation, further examined in item III.B.5 below.

Respondents were asked to provide their perspectives concerning:

(i) how critical board diversity is, and what should the criteria be (i.e., age, expertise, experience, gender, ethnicity); and

(ii) how proactive should regulators be in this matter, and what regulatory approaches should be adopted.

Survey results indicate that a large majority of respondents (78 out of 82)[48] acknowledged the importance of a balanced and diversified board.

Respondents, through various expressions, were of the view that board diversity is important to facilitate inclusiveness of the diverse shareholder base that boards serve, and that it is essential to improve the efficiency and effectiveness of decision-making processes.

Diversity is highlighted as a key element that promotes constructive challenges and debates of various perspectives. Stated otherwise, board diversity cultivates and ensures the combination of complementary approaches to corporate management and decision-making[49].

SC Malaysia considers board diversity (experience, skills, competence, race, age, gender, culture and nationality) as essential for effective board performance[50], and it indicated that gender diversity is increasingly recognized as an important component of inclusive growth. Lack of diversity, as highlighted by *CMB Turkey*, may represent a missed opportunity to consider new thinking, insights and experiences, negatively impacting the board's performance.

Respondents believe that in order to achieve such benefits, board diversity should focus on **complementarity of skills, experiences and expertise**. Respondents agreed on the relevance of these elements for corporate governance. Moreover, 23 respondents (including 10 regulators[51]) were of the view that complementarity of skills, experience and expertise are key elements.

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48 CNV Argentina and three Russian entities presented different views. Russia AII expressed that board diversity is not important, in a way that attention should be given to overall performance of the board and its members. CNV Argentina highlighted that there is no specification regarding board diversity in Argentinean laws, but companies can voluntarily adopt proper parameters if they consider the issue relevant. In the same sense, Russian VTB Bank JSC and PJSC "Severstal" pointed out that regulators should not interfere in issues of board diversity, as this is a matter for companies to address.

49 SVS Chile emphasized that board diversity represents a harmonious environment and best preparation to promptly deal with changes, and also creates the systematization of debates or exposure to diverse ideas, views and opinions on the board. MINDA Malaysia refers to a research that shows diversity leads toward productivity and effectiveness because it maximizes different skill sets and approaches of each individual.

50 Bursa Malaysia requires listed issuers to disclose, in annual reports, their policy on board composition regardingthe mix of skills, independence and diversity (including gender diversity and diversity in ethnicity and age) required to meet the needs of the listed issuer.

51 The Bank of Russia, Dubai FSA, Egypt FSA, SEC Bangladesh, CNBV Mexico, SEC Thailand, SEC Trinidad and Tobago, CMB Turkey, Israel ISA, SCA United Arab Emirates, Russia NSD, Sberbank of Russia, Argentina MAE, Argentina BBVA, Saudi Arabia SABIC, Saudi Arabia United Electronics

With respect to other issues raised through the CGTF Questionnaire, such as age, gender and ethnicity, there was no consensus on their relative importance or whether they should be a matter of concern for regulators.

Egypt FSA expressed the view that ethnicity and age are not relevant issues[52]. *FSB South Africa*, however, highlighted that increasing the level of female, black and young directors should be a focus for regulators, given the inadequate representation of these individuals in the majority of boards[53]. The idea that supports the inclusion of these groups is the opportunity to introduce a "*fresh perspective into the boardroom*" [54].

Other jurisdictions have taken diversity initiatives a step further and impose mandatory requirements on companies, such as quotas, particularly for gender diversity. In *Israel*, if all board members are of the same gender, companies are required by law to elect a director of the other gender. In *India*, it is mandatory to appoint at least one woman as a member of the board.

In addition to existing requirements, some respondents also indicated they were in favor of establishing gender and/or age quotas[55].

However, another group of respondents expressly acknowledged the importance of a board with diversified gender, age and ethnicity, but were skeptical about the appropriateness or utility of policy makers instituting hard rules, such as quotas. These entities suggested that board diversity should be encouraged through recommendations, promotion initiatives or disclosure requirements (i.e., "comply or explain")[56].

Company, Saudi Kayan, Saudi Arabia Yansab, Brazil ABRASCA, Brazil BM&FBOVESPA and Corporate Governance Centre of the Catholic University of Chile.

52 Other regulators, as Dubai FSA, also pointed out the absence of requirements regarding these criteria.

53 Saudi Savola, in the same sense, pointed out that regulators should encourage companies (i) to avoid nomination of eldest members and (ii) have women in board, whereas it is a rare position in Saudi Arabia.

54 At least one regulatory body in South Africa aids in advancing these perspectives. The Johannesburg Stock Exchange ("JSE") for example recommends that when identifying candidates for appointment/election to the board, consideration should be given to diversity criteria such as age, ethnicity, geographic background and gender. The JSE also recommends that companies, in addition to their own recruitment efforts, engage independent external advisors to search for and vet potential candidates that meets the board's skills and diversity criteria.

55 FSC Jamaica is amenable to the imposition of mandatory quotas as one of the possible initiatives regulators may adopt to promote board diversity. KNF Poland, MNB Hungary (for financial institutions), SV Dominican Republic and UAE Hawkamah also mentioned this possibility regarding gender diversity (this last entity understands that age diversity must also be mandated).

56 ICGN and CMB Turkey suggested that regulators should establish, at least, a reporting policy on gender issues. In Chinese Taipei, listed companies are encouraged to voluntarily adopt the diversity policy for board members set forth in Corporate Governance Best Practice Principles (article 20) and Corporate Governance Evaluation System (Indicator 3.32 and 3.35)..FSB South Africa, in its turn, reported that Johannesburg Stock Exchange Listing Requirements recommends companies to consider diversity criteria (gender, age, ethnicity and geographic background) when identifying candidates for appointments. Bursa Malaysia also expressly pointed out that diversity is a theme that should be addressed in the f sustainability statement in the annual report of companies. Accordingly, at least the

Accordingly, *T. Rowe Price* considered it "*premature*" to establish diversity-based targets or objectives in most GEM jurisdictions. Instead, it suggested that the best regulatory approach should comprise: (i) standard disclosures of the company's assessment of board diversity; and (ii) a combination of initiatives to foster diversity, such as limits on the number of boards on which an individual director can serve[57], stronger independence requirements, retirement age policies, and well-structured director education or credentialing programs.

FSC Jamaica pointed out that due regard should also be given to the discretionary nature of these measures, and to the fact that lack of board diversity is rooted in cultural, social and economic norms that have traditionally excluded diverse groups from participation in economic affairs. As experience has shown, increasing diversity on boards has not achieved the appropriate level of success, where it has historically been the practice to disenfranchise, exclude and undermine minorities, ethnic and other diverse groups from critically important socioeconomic events[58].

The recommended approach, therefore, seems to be a combination of mandatory and discretionary measures to cultivate board diversity, subject to adjustments, as the circumstances warranted.

Board diversity, then, should not just be viewed from an economic perspective, but as part of a broader social issue where attitudes and norms need to change. The initiatives to encourage board diversity in this regard could take the form of ongoing efforts to recalibrate cultural, economic and social thinking, particularly of the next generation.

Table III.B.2. Summary of responses on board diversity:

Most respondents indicate that board diversity should be encouraged through, among others, disclosure requirements (e.g., "comply or explain"), recommendations and guidelines. Survey results also reveal that efforts should focus on ensuring that a board has complementary skills, experiences and expertise.

b.3) Time commitment

As to whether regulators should consider limits on the number of boards on which a director serves, the majority of respondents are in favor to a policy that defines this limit strictly:

(i) 39 entities, of which 17 were regulators, agreed that limits should be imposed by regulators;

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following respondents were supportive to the efforts and initiatives in this regard: CMC Angola, FSC Mauritius, SMV Panama, SEC Thailand, Aberdeen, Schroders, Argentina BBVA and MICG Malaysia.

57 Further analyzed in item III.B.3 below.

58 Many jurisdictions lack a culture of inclusiveness that treats all demographic groups equally, in a way that, historically and culturally, these groups are deemed as inadequate to hold office of importance.

(ii) 26 entities, of which 10 were regulators, disagreed with establishing mandatory requirements.

This question stems from Principle E, Item 3, of the OECD Principles, which states "*Board members should be able to commit themselves effectively to their responsibilities*"[59].

The principal reason put forth for the establishment of an optimal limit is the need to secure the directors' diligence, commitment and the attention necessary for them to adequately and effectively execute their obligations.

However, other jurisdictions and entities understand that these objectives could be obtained through a more effective, principle-based approach, rather than through the imposition of limits. In this regard, *FSS Korea* highlights that regulators should take a prudent approach in this matter, considering that limiting the number of boards in which a director could serve may undermine the independence of both directors and companies.

As stated by *T. Rowe Price*, limitations on board commitments may extend beyond the question of time management, and constitute an impediment to diversity and board refreshment. In addition, it proposed that given the increasingly complex and time-consuming demands put on directors, excessive board appointments should be avoided, in a way that directors should not be allowed to serve on more than five corporate boards at a time.

Jurisdictions affirmative for the establishment of limits varied. Among these 17 regulators, six neither specified nor suggested what the limit should be[60]. On the other hand, among the 11 regulators that provided a numerical limit, the most common approach was to institute a limitation on **five boards**, in accordance with *T. Rowe Price*'s view[61].

Schroders, in its turn, points out that they have historically agreed with the proposition to limit directors to no more than five boards. Nonetheless, in light of the increasing demands on directors, they indicated they were inclined to reduce this number, based on the analysis of the following variables: (i) complexity of business, (ii) attendance rate at company meetings and (iii) other commitments of the individual in question.

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59 Based on the assumption that service on too many boards can interfere with the performance of board members.

60 In this sense, Egypt FSA, FSB South Africa, CSRC China, CMF Tunisia, SMV Panama, NBFIRA Botswana.

61 CMA Saudi Arabia, FSA Romania, SCA United Arab Emirates, SEC Thailand and SEC Trinidad and Tobago. This last one, in case, pointed out the absence of current mandatory requirements in this sense, however, affirmed that, giving the expected performance and technical skills and abilities required to serve as a director and daily, it is unlikely that a board member can serve effectively on more than five boards. SEC Thailand also pointed out that the limit of five boards is not mandatory in their jurisdiction, but a best practice recommended by the Stock Exchange of Thailand. Other limits set forth by regulators include the following: SEBI India and SEC Pakistan (seven boards), FSC Chinese Taipei (four boards) and SEC Bangladesh (three boards). CMB Turkey, in its turn, also sets a limit of three boards just for independent board members. SV Dominican Republic highlighted that their legislation states that a board member may not serve on more than one board of directors of another market participant.

The *World Bank* also highlighted that, if established, limitations should not be restricted to listed companies, considering that the non-listed sector can also present fairly huge and complex businesses.

These criteria also reveal that establishing a limit is subject to several variables that might compromise the effectiveness of a "mathematical" limit[62].

In this sense, the *ICGN*, which does not favor a strict limit on number of boards, indicates that the core point of attention should be a regular review and assessment regarding:

(i) the allocation of sufficient time, by directors, to prepare and attend board meetings; and

(ii) the directors' knowledge concerning the business, allowing them to contribute effectively to board discussions and decisions.

This is consistent with the approach of *CMA Kuwait*, whose rules do not include limits on time availability, but encourage board members to allocate enough time to execute assigned roles and responsibilities.

The Malaysian Code on Corporate Governance 2012 recommends that the board should set out expectations on time commitment for its members and protocols for accepting new directorships.

These difficulties and restrictions permeated the answers of the **26 respondents**[63] **that were not favorable to the establishment of strict limitations**.

Four alternative regulatory approaches were suggested to ensure that directors allocate sufficient time to discharge their obligations to boards[64]:

(i) **Transparency** was cited by the *Corporate Governance and Capital Market Centre of the University of Chile* as the best approach to address this issue, along the same lines as the *ICGN* approach, which highlights the importance of clearly **disclosing**, to investors, these elements, and other aspects regarding

62 Accordingly, the OECD recognizes "specific limitations may be less important than ensuring that members of the board enjoy legitimacy and confidence in the eyes of shareholders".

63 Including ICGN, CNV Argentina, CNBV Mexico, MNB Hungary, KNF Poland, SVS Chile, Dubai FSA, FSS Korea, The Bank of Russia, HANFA Croatia, Israel ISA, Corporate Governance and Capital Market Centre of the University of Chile, Corporate Governance Centre of the Catholic University of Chile, Russia NSD, Sberbank of Russia, Russia AII, Russia PJSC Inter Rao, Russia PJSC Severstal, Russia PJSC Norilsk Nickel, Argentina BBVA, Argentina MAE, Brazil ABRASCA, Brazil AMEC and Brazil BM&FBOVESPA. It is worth mentioning that HANFA Croatia, although expressing their views that regulators should not consider the establishment of limits, pointed out the existence of legal limitations (Croatian Companies Act seals a director to act in more than 10 boards) and related corporate governance code's provisions (executive directors or managers may not be a member of more than 7 supervisory boards) in that sense.

64 Reference to sufficient time is made, among others, by the Russian Corporate Governance Code. In Brazil, the Corporate Governance Code, which is being drafted by market entities, also takes this view into account, without establishing a limiting number of boards.

the individual directors' capacity to undertake multiple directorships, especially considering that many investors may have their own policies and views against director "*overboarding*". This view was also referred to by *CFA Institute*, which highlighted the importance of disclosure regarding how many board positions each board member may have, allowing investors to know how each board member allocates his time. Similarly, *Brazilian Association of Capital Markets Investors (AMEC)* pointed out the importance of regulators mandating disclosure on board evaluation and quantitative data such as the number of meetings, attendance and committee work[65], in order to enable investors to exercise judgment on the adequacy of the work done by the board and the limits put on individual directors serving on multiple boards[66]. The *Russian Corporate Governance Code* also recommends board members to have sufficient time for their duties and advises them to notify the board of their intention to take office with another organization immediately after appointment;

(ii) **Self-assessment** was another approach reported by entities, who pointed out requirements or recommendations aimed at making board members (or nominees) responsible for their own evaluation. In *Israel*, the law requires individuals to declare whether they have the ability to dedicate the appropriate amount of time required to perform their duties. Accordingly, *FSB South Africa* reports that, in its jurisdiction, the onus is on the individuals to determine whether or not they have the time, skill, experience, and capacity to make a meaningful contribution to the company[67];

(iii) **Conflict of interest policies**: *MNB Hungary* and *CNV Argentina* have highlighted that regulators should also ensure proper "conflict of interests" policies, preventing board members from holding positions that could lead to conflicts, such as activities that compete with the company[68];

(iv) **Formal parameters**: the establishment of parameters and conditions of time and dedication was another possible approach reported by *CNBV Mexico*. Board members of Mexican listed companies are recommended to meet at

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65 Although SEC Trinidad and Tobago expressed their favorable views regarding the limitation on boards, they also pointed out the existence of disclosure requirements in their regulation. For SEC Thailand, listed companies are required to disclose the number of meeting held each year as well as each director's attendance of such meetings.

66 Principle E, Item 3, of the OECD Principles: "Disclosure about other memberships to shareholders is therefore a key instrument to improve board nominations. 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".

67 FSC Mauritius, accordingly, emphasized time commitment as one of the factors to be considered in the appointment of a person as director. In this jurisdiction, the prospective director should be able to demonstrate whether he/she has sufficient time to be devoted for the job.

68 It is also prohibited in Brazil in accordance with Brazilian Corporate Law (Article 147, §3º, I). Egypt FSA also highlighted this issue as a point of attention in the discussion regarding eventual limitation to directors' performance in multiple boards.

least four times per year, and recommended attending at least 70% of the scheduled meetings during one-year calendar[69].

Table III.B.3. Summary of responses on time commitment:

Survey results indicate that: **(i) factors that may impact time commitment should be reviewed and disclosed, such as (a) performance indicators, (b) quantitative data (e.g., number of board meetings, attendance), (c) other commitments of the directors and (d) self-assessment concerning how they allocate their time to properly perform their duties; and** **(ii) companies should objectively define parameters and conditions in order to measure the required time directors should devote to act effectively in light of their business segment, complexity and characteristics[70].**

b.4) Nomination subcommittee

The OECD Principles recommend that the board should consider setting up proper specialized subcommittees to better support its core functions, including the members' nomination and appointment processes.

The CGTF Questionnaire invited respondents to express their opinion regarding regulators mandating nomination subcommittees, as well as report current practices and measures in place within their jurisdictions[71].

Among the 31 GEM regulators that provided their views, only four jurisdictions[72] expressly reported that a nomination subcommittee should not be required by regulators, as this decision is best left to companies.

69 Mexican Code of Best Corporate Practices. The World Bank pointed out that the standard for listed companies (assumed fairly complex businesses) should be a bare minimum of monthly meetings. The SEC Thailand also reported that the Stock Exchange of Thailand recommends for the board to set its meeting schedule and agenda in advance and notify each director of the schedule for each to manage time to attend meetings. The appropriate number of meetings is recommended to be at least 6 times per year. It is also should be recommended by the chairman of the board to encourage all directors to attend at least 75% of all the board meetings held during the year. In addition, non-executive directors are recommended to meet, as necessary, among themselves without the management team in order for them to debate their concerns. The non-executive directors are then recommended to notify the managing director about the meeting outcomes.

70 This information should be reflected in the nomination and appointment process of directors.

71 The World Bank noted that nomination subcommittees were originally developed for markets with dispersed ownership, preventing executives from controlling the nomination process. In jurisdictions where companies present high share concentrations (which is the rule in emerging markets), the logic for a nomination subcommittee is much more nuanced, since investors will always appoint directors. In this sense, the key issue is to identify independent directors, and also feed investors with the needs and requirements of the board, as expertise and diversity.

72 Israel ISA, KNF Poland, SSF El Salvador and SEC Pakistan.

Four other jurisdictions[73], on the other hand, reported the absence of specific requirements for the formation of a nomination subcommittee. Three of them, however, recognized the importance of the practices that usually fall within the scope of such committees[74].

The survey's results revealed a broad agreement on the importance and potential benefits of establishing independent nomination subcommittees[75] (26 out of 31 regulators).

A specialized subcommittee, as highlighted by *Dubai FSA*, may facilitate the evaluation of skills, knowledge, independence and experience on the board, properly recommending the role and capabilities required for a particular appointment.

Other respondents have suggested different regulatory approaches in this regard.

Ten regulators[76] were in favor of mandating the establishment of nomination subcommittees. In *Malaysia*, a listed issuer is required under the Listing Requirements to establish a nomination subcommittee and disclose the assessment it undertakes in respect of the board, its committees and individual directors, together with the criteria used for such assessment to ensure that each director, chief executive or chief financial officer has the appropriate character, experience, integrity, competence and time to effectively discharge their roles. The *CFA Institute* accentuated that an independent nomination subcommittee helps ensure boards have a process to recruit and maintain independent and well-qualified directors[77].

Twelve regulators[78], on the other hand, stated that regulators should encourage the establishment of nomination subcommittees, but not make it a mandatory requirement. Many of these respondents argued that regulators should foster the implementation of such

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73 SVS Chile, CNBV Mexico, CMC Angola and SV Dominican Republic.

74 In this sense, *Chilean* law requires companies to establish formal procedures aiming to inform investors about: (i) diversity, skills, conditions and experiences expected of the board members; (ii) maximum number of boards a director should serve; and (iii) experience and profile of candidates for director, and their eventual relationship with the controlling shareholder, as well as main competitors or suppliers. *CNBV Mexico*, more concisely, pointed out that the regulatory framework should be robust enough to ensure guidance for the selection and appointment process. Brazil AMEC also emphasized that this process and related practices should be fully transparent.

75 10 jurisdictions (CSRC China, FSB South Africa, SEBI India, The Bank of Russia, SSC Vietnam, FSS Korea, SEC Trinidad and Tobago, Dubai FSA, SEC Thailand and FSA Romania) expressly referred to the needed independence of such committees, reflected in their composition (majoritarian or entirely independent). The independence was also pointed out by ICGN, Schroders and Aberdeen as a requisite for an effective performance of nomination subcommittees.

76 CSRC China, CMA Saudi Arabia, SCA United Arab Emirates, SEBI India, FSC Mauritius, FSS Korea, CMB Turkey, SMV Panama, SEC Bangladesh, SC Malaysia. Panama and Bangladesh reported they currently do not have mandatory requirements in their jurisdiction, but considered it as a good measure. However, SEC Bangladesh mentioned that nomination subcommittees would be in its regulatory framework in the near future.

77 Accordingly, they emphasize listed companies should have a nomination subcommittee and disclose whether each member is independent.

78 The Bank of Russia, FSB South Africa, HANFA Croatia, CNV Argentina, Dubai FSA, SSC Vietnam, FSC Chinese Taipei, FSA Romania, SEC Trinidad and Tobago, Egypt FSA, CMA Kuwait and NBFIRA Botswana. In Russia, it is worth mentioning that Tier 1 listed companies are not recommended, but required to have a nomination subcommittee.

committees by means of recommendations[79] or on a "comply or explain" basis[80], considering factors such as the size of the company[81] and its business complexity[82], so as to avoid burdening companies with unnecessary or disproportional costs.

At least nine jurisdictions highlighted that regulators should restrict such requirements or recommendations to large companies[83].

Based on the survey's results, there is a general appreciation among GEM jurisdictions regarding the importance of nomination subcommittees as an effective tool to promote qualified, independent and suitable nomination and appointment processes of board members.

Finally, the establishment of specialized subcommittees in order to ensure proper nomination and appointment processes, aligned with companies' characteristics and needs, is closely linked to compensation, further addressed in Section IV[84]. Structures may vary, but some essential elements shall be attuned. In other words, nomination, remuneration and assessment of the performance of board members should be jointly or coordinately addressed, and even merged into one single structure or subcommittee.

Table III.B.4. Summary of responses on nomination subcommittees:

Survey's results indicate that:

(i) there is a need to ensure companies have effective guidelines for the selection and nomination of board members, either through the establishment of nomination subcommittees or alternative measures;

(ii) the establishment of specialized nomination subcommittees should consider the company's size, so as to avoid excessive or unnecessary regulatory costs;

(iii) a nomination subcommittee should be composed of a majority of independent members.

b.5) Board evaluation

79 The Bank of Russia.

80 Dubai FSA and SEC Thailand.

81 SEC Trinidad and Tobago.

82 SEC Thailand.

83 FSS Korea, CMB Turkey, SVS Chile, FSB South Africa, CNV Argentina, SEC Trinidad and Tobago, HANFA Croatia, Egypt FSA and MNB Hungary. In Turkey, as reported by CMB, when the establishment of a nomination committee is unreasonable, their own functions shall be assimilated by the corporate governance committee. In addition, it is worth mentioning that, in Hungary, nomination subcommittees are only required to specific market segments, encompassing credit, investment and financial companies. MNB Hungary also considers the setting up of a nomination sub-committee for large size and complex financial institutions.

84 As pointed out by *CMA Kuwait*, it is more effective in terms of costs, and also to create better outcome of companies' productivity and achieving balance between companies and shareholders' interests.

The OECD Principles highlight the potential benefits of regular board evaluations, which, if well implemented, have the power to improve board practices and performance of its members. In this regard, board evaluations are key elements for holding board members accountable for their decisions. These evaluations are necessary for assessing the competence, skills and diversity of the board.

The OECD also states that some jurisdictions have encouraged companies to engage in voluntary board evaluations, taking into account their needs and objectives[85]. Many jurisdictions have recommended or mandated board self-assessments (also including evaluation of board members' and key executives' individual performance)[86]. It is also noted that, particularly in large companies, board evaluations can be supported by external facilitators in order to promote an objective appraisal.

The question raised with GEM jurisdictions was aimed at expanding on the existing OECD recommendations, by collecting views on:

(i) when and how these evaluations should be conducted[87]; and

(ii) the best regulatory approach to foster the implementation and effectiveness of such evaluations.

The responses indicate that, in order to ensure efficient performance of the board, the majority of jurisdictions have encouraged annual board self-assessment, as well as individual evaluation of board members' performance, based on their professional and personal qualities[88]. However, there is no uniformity regarding the way to conduct such assessments[89]. Essentially, board members are asked to determine how efficiently the board has operated, how members have worked, and to provide ideas for improvements.

Regarding how regulators should foster the implementation of periodic evaluations of the board, most respondents noted that each company may have its own system of periodic evaluation, suitable to their characteristics and targets.

Regarding the option of hiring an external facilitator to perform the assessment, this issue met significant resistance from entities, generally justified on the grounds of cost-benefit. For

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85 Chapter VI, Principle E, Item 4.

86 Chapter VI, Principle D, Item 2.

87 This is, its periodicity and whether there should be required the recruitment of an external facilitator or self-assessments reports.

88 As means of illustration, CMA Kuwait encourages, under a "comply or explain" approach, evaluation of board members' performance in a form of Key Performance Indicators (KPI). Malaysian listed companies are required by Bursa Malaysia to conduct (and disclose the results of) a periodical assessment, through the nomination committee, concerning the board, subcommittees and individual directors. Stock Exchange of Thailand issued a self-assessment form for the board and its subcommittees to evaluate their own qualifications and performances at individual level. The assessment is recommended to be conducted regularly (i.e. at least once a year). The process, criteria and results of such assessment are then recommended to be disclosed in the annual report.

89 For example, some companies require members to elaborate their comments and proposals, based on a questionnaire.

those jurisdictions and entities that have in place evaluations by external facilitators, the period for such evaluation is usually once every three years[90]. Respondents argued that a company would have to seriously consider the projected benefits when recruiting an external facilitator, owing to the costs involved.

Table III.B.5. Summary of responses regarding board evaluation:

Board evaluation by independent external facilitators should be encouraged. Based on the responses, it is also possible to conclude that regulators should focus on the implementation or refinement of requirements concerning a periodical assessment of the board.

C. Key takeaways

Based on the standards set out in Chapter VI of the OECD Principles, and the views and practices reported by respondents of the CGTF Questionnaire, the CGTF provides the following takeaways to be considered by emerging market regulators:

III.C.1) An objective independent judgment of board members should be pursued through:

(i) full disclosure concerning any material aspects, such as personal or commercial relations, that might potentially skew decision-making processes; and

(ii) requirements and recommendations concerning (a) board structure and composition to ensure critical mass of independent directors[91], and (b) board members' and management competencies and accountability, so that they have the proper skills, experience and incentives to effectively challenge and contribute to board and management decisions. This might be achieved by fostering the induction and training of board members and management);

III.C.2) Board diversity should be encouraged through guidelines, recommendations and disclosure requirements, promoting a board with complementary skills, experiences and expertise, in order to bring a

90 Russian Corporate Governance Code. It is also relevant to note some alternatives pointed out by answers. Saudi companies, for instance, expressed the view that the separate Nomination and Remuneration Committees within the company are capable of performing objective evaluations. SEC Thailand reported that an external consultant to facilitate a board assessment is recommended, as a good practice, to be conducted at least once every three years, and the assessment results are recommended to be disclosed in the annual report. The external facilitator is also recommended at the time the decision making ability of an independent director is likely to be compromised, especially in the case of the chairman, who is in charge of assessing the board. The *CFA Institute* also argued that it would be advisable that boards periodically bring in outside and independent parties to evaluate their proper functioning.

91 Including a minimum number of independent directors (observed markets characteristics and legal requirements) and/or an adequate balance of executive and non-executive directors, should be the case.

holistic view to the debates and decisions, positively impacting board performance;

III.C.3) Companies should be encouraged to:

(i) review and disclose elements that may compromise an adequate and diligent allocation of time by directors (including performance indicators, quantitative data, and directors' self-assessment concerning how they allocate their time in light of company's needs); and

(ii) measure the appropriate time a director should devote to that specific board in light of its business segment, complexity and characteristics. These conditions should be clearly reflected in their nomination and appointment policy and process;

III.C.4) The establishment of nomination subcommittees should be encouraged to promote a transparent and independent nomination and appointment process of board members. These measures should consider company's size and business complexity in order to avoid excessive or unnecessary regulatory costs. If established, these subcommittees should comprise a majority of independent members; and

III.C.5) Board and individual director's self-assessments concerning their performance, based on a clear, transparent and suitable methodology, should be encouraged. Companies should consider hiring external facilitators to conduct board evaluation, especially for the initial design of a proper and independent methodology to be applied, in line with the company's characteristics and needs.

IV. REMUNERATION AND INCENTIVE STRUCTURES

Good governance of companies cannot be achieved without implementing an appropriate system of remuneration, which balances the interests of board members/executives and shareholders, and fosters business sustainability through proportional and adequate incentives. However, experience shows that getting the right balance may be a challenging task.

On the one hand, companies have to provide sufficient incentives to promote better performance, reward success, and attract and retain talented directors and executives in a highly competitive market. On the other hand, they need to avoid excesses and perceptions of rewarding failure, which has become a contentious topic in view of excessive amounts agreed or by remuneration schemes for executives that have led to extraordinary risk-taking and focusing on short-term earnings rather than sustainable profits generation and value creation[92].

The inclusion of compensation as one of the three focus areas of this Report is also in accordance with the perspective that mismatched incentives between value creation and sustainable profits generation could lead to undesired conduct by executives. This view is reinforced by previous financial crises, where individuals who, driven by immediate, disproportionate rewards or even by mere greed, have conducted business recklessly, hurting investor confidence, weakening capital markets as a result of misaligned incentives. Consequently, investors have come to realize that disclosing the structure and quantum of board and executive compensation is critical information.

In this context, investors also need to feel comfortable that decisions made do not sacrifice the company's future in the name of misleading or immediate returns. Investors must be allowed to understand in detail the components of existing remuneration plans, including short- and long-term bonuses and rewards, stock options and even termination and retirement provisions, in order to properly assess compensation rationale and adequacy. This would allow investors to understand how such elements may affect decisions, the conduct of business and long-term value creation.

Remuneration programs are still often overly complicated or obscure in ways that camouflage conditions and consequences. Key criteria, such as "performance", are usually not clearly defined, hindering an objective assessment of their impact[93].

The increased pressure on inappropriate, excessive or misaligned executive compensation has led to initiatives giving investors greater influence over executive pay through, for example, a

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92 Corporate Governance Centre of the Catholic University of Chile.

93 In order to deal with the "performance" vagueness, on April 2015, the USA SEC proposed rules to implement Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, defining performance as the "*total shareholder return on an annual basis*". However, although the adoption of a unique measure contributes to comparison among different companies, some questions remain open, as there is some uncertainty if this criterion can properly link performance with executive efforts (considering efforts and results might not be linearly related.

vote on companies' remuneration policies. This gives strength to the so called "say-on-pay" process, in which shareholders may play a more active role in determining remuneration[94].

This subject has also been debated by regulators in another angle, namely the negative consequences that may arise from wrong drivers of behavior, affecting the company, investor confidence and market stability. For example, the *Corporate Governance Centre of the Catholic University of Chile* points out compensation heavily weighted in favor of variable factors, such as share options as a way to reward top executives. Although they ideally provide strong incentive to directors and executives to create long-term shareholder value, they have also induced many managers to take greater risks to inflate stock prices[95].

As further examined in Section V of this Report, a higher risk-taking appetite is not, per se, undesirable neither will it necessarily result in worse performance. However, when related to compensation practices, if these are not properly linked to encourage long-term company value creation, they will most likely encourage wrong behavior.

Considering the guidelines set out by the OECD regarding incentive structures, and the need to better understand how capital market regulators should be positioned, the CGTF asked the survey respondents to describe current practices and to share their views concerning key topics in compensation.

A. Relevant OECD Principles

The OECD Principles emphasize that effective corporate governance frameworks "*should be developed with a view to its impact on overall **economic performance, market integrity and the incentives** created for market participants and the promotion of transparent and well-functioning markets*"[96]. In other words, it encourages an analysis of the impact on key variables that affect the functioning of markets, for example in terms of incentive structures.

Having said that, the OECD Principles recommend that shareholders should be able to make their views known on the remuneration of board members and/or key executives and on compensation practices[97].

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94 The say-on-pay is still a controversial process. The advocates of say-on-pay process defend its potential to increase the sensitivity of executive pay to performance, enhancing transparency and accountability to shareholders. Opponents of this process sustain that it is already a board's role to align their interests with those of the shareholders. In addition, they understand shareholders are not able to properly evaluate a compensation plan - with the risk of reducing board effectiveness - or may simply respond to special interests.

95 In this line, although many corporate governance codes stress that executive directors should build up a meaningful shareholding in their companies as an indicator of alignment of interests ("skin in the game"), the Turner Review has stated that: "*Many top managers of financial firms which suffered very large losses during the financial crisis were very large shareholders in their firms, and in several cases had voluntarily chosen to invest large proportions of cash bonuses in their firms' equity. But these stakes in the long-term profitability and stability of their firms did not seem to result in any greater awareness of or concerns about the risks the firms were running*". (Turner, 2009)

96 Chapter I, Principle A, of the OECD Principles.

97 Chapter II, Principle C.

Therein, Chapter V of the OECD Principles recognizes the importance of material information disclosure regarding compensation practices[98], allowing investors to assess the "*costs and benefits of remuneration plans and the contribution of incentive schemes, such as stock option schemes, to the company performance*"[99].

In Chapter VI, the OECD Principles make it clear that the board is ultimately liable for the alignment of key executive and board remuneration after taking into account the long term interests of the company and its shareholders[100].

Lastly, the OECD Principles also point out that the effectiveness of core functions of the board, as in the implementation and oversight of internal controls, ethics and compliance programmes, relies on the alignment of incentive structures with ethical and professional standards[101].

B. Analysis of survey results

Respondents to the CGTF Questionnaire described current practices in place and provided their views regarding compensation related issues. The inputs covered regulatory measures, requirements and policies that should be in place to promote transparency and ensure alignment of remuneration and incentives structures with companies (and capital market) sustainability.

The questions raised in the CGTF Questionnaire covered the following points:

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98 "*A. Disclosure should include, but not be limited to, material information on: (...) 4. Remuneration of members of the board and key executives*".

99 Shareholders should have full awareness regarding the following elements: (i) the remuneration policy, and the total amount of compensation arrangements made under such policy; (ii) the relation between remuneration and company performance, in order to allow them to assess the capability of the board; and (iii) the potential impacts of equity-based plans in shareholders' participation.

In addition, the OECD Principles state that disclosure on an individual basis is increasingly regarded as good practice, and point out the existence of mandatory requirements in some jurisdictions (where it may apply to the highest paid executives, or specified positions, as the case may be)

100 Chapter VI, Principle D: "The board should fulfil certain key functions, including: (...) 4. Aligning key executive and board remuneration with the longer term interests of the company and its shareholders".

This is to be done using objective and independent judgment with the participation of a specialized subcommittee, if the characteristics and scale of the company warrant it. Other standards in this field are also recommended as good practices, including the introduction of clawback provisions, which may result in the withholding and recovering of compensation from executives in cases of fraud and misconduct.

101 Chapter VI, Principle D, Item 7: "Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.

(...)

To be effective, ***the incentive structure of the business needs to be aligned with its ethical and professional standards*** *so that adherence to these values is rewarded and breaches of law are met with dissuasive consequences or penalties".*

(i) role of main corporate bodies in the establishment of remuneration practices and policies;

(ii) need for prior approval, in the shareholders meeting, of long-term equity-based and other incentive structures;

(iii) regulatory requirements concerning the establishment of remuneration subcommittees;

(iv) disclosure requirements related to executive and board compensation policies and individual compensations;

(v) regulatory requirements concerning balance between fixed and variable remuneration; and

(vi) regulatory requirements concerning "pay for performance" remuneration policies.

Despite the wide range of perspectives and, in some case, diverging views, the CGTF was able to identify trends and practical regulatory measures in order to promote adequate incentive structures.

b.1) Role of the different governance structures

29 GEM regulators gave their views on what should be the role of the main different corporate structures (shareholder meetings, board of directors, specialized subcommittees) in defining remuneration policies. The responses included the following:

(i) nine (9) regulators[102] took the view, in essence, that shareholders meeting should approve the remuneration policy, as recommended by remuneration subcommittee and approved by the board. This approval should be given for non-executive directors' remuneration, while the board of directors approves executives' remuneration. *CMB Turkey* not only highlighted that shareholders should be able to express their views regarding the remuneration of top management in accordance with the OECD Principles, but also stated that the shareholders meeting should have the main responsibility in making this decision, as defining the remuneration of the board is an exclusive authority of the shareholders meeting (that cannot be delegated)[103].

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[102] CSRC China, CMB Turkey, SC Malaysia, MNB Hungary, CNV Argentina, CMF Tunisia, FSB South Africa, Egypt FSA and Romania FSA.

[103] The Malaysian Code on Corporate Governance 2012 (Recommendation 2.3) states that the board should establish formal and transparent remuneration policies to attract and retain directors. Further, the Listing Requirements require that fees payable to directors can only be increased provided that the increase is pursuant to a resolution passed at a general meeting.

(ii) seven (7) regulators[104] indicated that the remuneration policy shall be set by a specialized remuneration subcommittee and approved by either the board or by the shareholders meeting.

(iii) four (4) regulators[105] indicated that the board should approve the remuneration policy.

(iv) three (3) regulators[106], without identifying which particular body should set the policy, took the view that shareholders should approve the board's remuneration, while the board should be in charge of approving executive remuneration[107].

(v) Multiple corporate bodies should be responsible for the formulation and approval of remuneration policies. This particular approach was put forward by *ISA Israel*[108], where Israeli Companies Law requires that the remuneration policy shall be approved, every 3 years, by (a) a compensation subcommittee, (b) the board and (c) the majority of the minority shareholders in the shareholders meeting.

Table IV.B.1. Summary of responses regarding role of main corporate bodies:

It can be observed that most of the respondents agree that shareholders should be allowed to express their opinion on remuneration policies formulated by the board of directors (or by a specialized remuneration subcommittee, should there be one).

b.2) Advanced approval by shareholders meeting

The OECD Principles recommend that all equity-based compensation plans should be approved by the shareholders meeting.

28 GEM regulators responded to the question whether the shareholders meeting should approve in advance all long-term equity-based and other incentive structures or any substantive changes to existing plans.

104 FSC Mauritius, HANFA Croatia, FSC Chinese Taipei, CMA Saudi Arabia, SCA United Arab Emirates, SEBI India and CNBV Mexico.

105 FSS Korea, CSRC China, SEBI India and CMC Angola.

106 SEC Pakistan, Egypt FSA, NBFIRA Botswana and The Bank of Russia.

107 SEC Thailand reported that Stock Exchange of Thailand recommends in its best practice for the shareholders meeting to approve remuneration policy of the board and the executives. While shareholders should also decide on the board's remuneration, the latter should approve those of the executives.

108 ISA Israel.

The majority of regulators (19)[109] indicated that shareholders should approve long-term equity based and other incentive structures.

On the other hand, according to some responses (including 3 regulators)[110], long term equity and related incentives structures should be approved by the board.

Other respondents[111] indicated that the shareholders should approve remuneration for the board, while the board should approve the remuneration for the executives.

Table IV.B.2. Summary of responses regarding advanced shareholder approval:

Most of the respondents are positive to require advanced shareholder approval for equity-based incentive structures.

b.3) Remuneration subcommittee[112]

Setting up specialized subcommittees to support the full board in addressing remuneration policies in large companies is recommended by the OECD[113], which also points out the importance of allocating a sufficient number of non-executive board members capable of exercising independent judgment to board remuneration issues.

29 GEM regulators answered the question on whether regulators should require companies to have a remuneration subcommittee to regularly review incentives, as well as describe its desired composition.

Based on the responses, it would appear that there is a difference of opinion regarding mandating the existence of a specialized remuneration subcommittee:

(i) Regulators should not mandate the setting up of remuneration subcommittees. This was the view of ten (10) regulators[114]. For example, the *Bank of Russia*

109 CSRC China, HANFA Croatia, CMA Saudi Arabia, Egypt FSA, SEC Thailand, NBFIRA Botswana, SEBI India, MNB Hungary, FSS Korea, CMB Turkey, SC Malaysia, SCA United Arab Emirates, KNF Poland, ISA Israel, FSA Romania FSA, CNV Argentina, SEC Trinidad and Tobago, CMC Angola, SV Dominican Republic and FSB South Africa. SEC Thailand requires shareholders to approve in advance and specify clearly on all long-term equity based and other incentives schemes regardless of whether it is monetary or non-monetary compensation for the directors (including independent, executive and non-executive).

110 The Bank of Russia, FSC Mauritius and Dubai FSA (shareholders can ask for clarity at the shareholders meeting).

111 SEC Pakistan and SEC Thailand.

112 Although making reference, in essence, to the same committee, survey results reveal different denominations (such as remuneration committee, remuneration subcommittee, compensation committee, compensation subcommittee). For purposes of standardization, thus, reference is made, in this Report, to Remuneration Subcommittee.

113 It is also recommended that board committees' mandate, composition and working procedures should be well defined and disclosed by the board.

114 CNBV Mexico, HANFA Croatia, SSC Vietnam, Dubai FSA, SEC Thailand, FSC Mauritius, NBFIRA Botswana, KNF Poland, SMV Panama, SSF El Salvador, Oman Centre for Governance and Sustainability, Brazil BM&FBOVESPA, Brazil ABRASCA, Brazil AMEC, Argentina MATba, besides

indicated that, although it is not mandatory, the Russian Corporate Governance Code recommends its establishment. In *Romania*, the FSA reported that the law on private companies provides the possibility, but not the mandatory requirement for the board of directors to establish a remuneration subcommittee. In *Brazil*, there is no such regulatory requirement, but the Brazilian Corporate Governance Code, currently being drafted by several market entities under a "comply or explain" basis, will recommend the establishment of such a subcommittee. Similar approaches are implemented in Malaysia (Malaysian Code on Corporate Governance 2012[115]) and in Thailand (Stock Exchange of Thailand's Best Practice on Good Corporate Governance).

(ii) On the other hand, there are mandatory nomination and/or remuneration subcommittees in place in at least twelve (12) jurisdictions[116].

ICGN highlights that a specialized remuneration subcommittee should be responsible for integrating all components of remuneration into a cohesive structure, aligned with and supporting the strategic short- and long-term objectives of the company. *CFA Institute* also highlighted the responsibility of such committee to adequately communicate to shareholders how pay in both the long-term and short-term aligns with value creation.

The analysis of the answers also allows us to identify the other main responsibilities of remuneration subcommittees, as follows:

(i) establishing efficient and transparent remuneration practices.

(ii) regular review of incentive structures;

(iii) reviewing of awards on an annual basis and discussing the outcomes of existing plans;

(iv) conducting an annual review of the requirement of suitable skills required for membership;

(v) reviewing the structure of the Board of Directors and recommend changes; and

(vi) ensuring on an annual basis that newly appointed board members are independent.

Russian (JS Company "R.O.S.T Registrar", PJSC "Severstal") and Saudi (Tadawul, Eastern Province Cement Company and United Electronics Company) entities.

115 Recommendation 2.3 of the Malaysian Code on Corporate Governance 2012 states that the board should establish formal and transparent remuneration policies to attract and retain directors. It further adds in the Commentary to the Recommendation that the board should establish a Remuneration Committee to perform this function, and the committee should consist exclusively or a majority of non-executive directors, drawing advice from experts if necessary. Companies without a Remuneration Committee should have board policies and procedures on matters that would otherwise be dealt with by the Remuneration Committee.

116 FSB South Africa, SC Malaysia, CMB Turkey, ISA Israel, HANFA Croatia, CSRC China, Egypt FSA, SEBI India, MNB Hungary, FSS Korea, SEC Trinidad and Tobago and CMA Saudi Arabia.

On the expected composition of the remuneration subcommittee, the majority of respondents indicated that it should be composed and chaired by independent directors[117].

This view is shared by relevant institutional investors[118]. Some respondents also pointed out that these characteristics foster the definition of compensation structures aligned with the entity's culture, objectives and strategy. In addition, *ICGN* highlights that the subcommittee should comprise entirely independent non-executive directors or supervisory board or at least a majority of independent members.

Table IV.B.3. Summary of responses regarding remuneration subcommittees:

There is a slight prevalence of the opinion towards the establishment of remuneration subcommittees, provided that this regulatory requirement takes into account the company's size and industry sector[119].

With respect to its composition, the common view or practice is for the remuneration committee membership to comprise a majority of independent non-executive directors.

b.4) Disclosure of policies and individual compensation

The OECD Principles call for the disclosure of remuneration of board members and key executives including the remuneration policy, the total value of compensation arrangements and particularly, the link between remuneration and long term company's performance. They also recommend that this should be disclosed on an individual basis, including termination and retirement provisions.

29 GEM regulators expressed their views on whether executive and board compensation policy as well as the amount of individual compensation should be disclosed in periodical reports.

The majority of respondents referred to regulations, laws or recommendations enforcing the disclosure of executive and board compensation policies, with this information mostly being required to be disclosed in the annual reports.

For example, *Dubai FSA* requires the company's annual report to have sufficient information regarding the overall remuneration policy and strategy, demonstrating how they "*properly link rewards to individual performance and outcomes*", and do not "*induce inappropriate risk taking by such individuals*"[120]. The *ICGN* states that the remuneration policy should be

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117 This feature was noted to apply mostly to listed companies, having MNB Hungary mentioned that it also applies to certain credit institutions, investment firms and collective investment firms.

118 Such as Aberdeen and Schroders.

119 In line with Chapter VI, Principle E, Item 2 of the OECD Principles.

120 CMA Kuwait, in its turn, encourages the establishment of a remuneration policy including the determination of the remuneration of board members, and requires the disclosure of detailed explanation of remuneration of board members and executives in its annual report.

disclosed in a clear, understandable and comprehensive way. *CSRC China* requires listed companies to disclose essential elements, such as the decision-making process, the determination basis and the actual payment. *CVM Brazil* requires[121] companies to describe compensation policies of all corporate bodies, including executives, board of directors, the supervisory board and eventual subcommittees. In *Brazil*, this disclosure must include the objectives, rationale and detailed components of such policies, with the description of the relevant performance indicators, and how they are aligned with corporate short, mid and long-term goals[122].

FSB South Africa also pointed out the importance of clear disclosure of the total amount and the rationale behind any pensions, end-employment contracts and any termination payment to senior executives. This is critical to avoid companies being obliged to pay special severance or compensation on termination of employment contracts arising out of failure or incapacity to perform, or underperformance against contracted objectives.

Disclosing individual remuneration, however, is controversial. In some jurisdictions, companies are required to provide full disclosure of each individual executive and non-executive director's remuneration. Different approaches to do this were reported, as follows:

(i) legal provisions, as in *South Africa*[123];

(ii) regulatory frameworks regarding annual reports, as in *Chinese Taipei*[124], *Saudi Arabia*[125], *Botswana* and *Poland*;

(iii) recommendations, as in *Russia*[126];

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121 CVM Instruction No. 480/2009.

122 KNF Poland states that compensation structures should "tie the level of remuneration of members of the company's management board and key managers to the actual long-term financial standing of the company and long-term shareholder value creation as well as the company's stability". In this sense, as a concrete measure, reference is made to Best Practice of WSE Listed Companies 2016, which recommends Polish listed companies to adopt a minimum period of 2 years between the allocation of options or other equity-based incentive instruments and their exercisability.

123 South African Companies Act of 2008 (Section 30 read with sections 66(8) and 66(9): Annual financial statements and remuneration of directors of a company; Subsection 4-6).

124 In accordance with Taiwanese annual reports regulations (article 10, paragraph 3). FSC Chinese Taipei points out the following rules require disclosure of individual remuneration of director/supervisor:

"*1) A company that has posted after-tax deficits in the parent company only financial reports or individual financial reports within the two most recent fiscal years;*

2) A company that has had an insufficient director/supervisor shareholding percentage for 3 consecutive months or longer during the most recent fiscal year;

3) A company that has had an average ratio of share pledging by directors or supervisors in excess of 50 percent in any 3 months during the most recent fiscal year;

4) If the total amount of remuneration received by all of the directors and supervisors in their capacity as directors or supervisors of all of the companies listed in the financial reports exceeds 2 percent of the net income after tax, and the remuneration received by any individual director or supervisor exceeds NT$15 million".

125 CMA Corporate Governance Regulations.

(iv) "comply or explain" basis, as stated by *CMB Turkey*.

Institutional investors[127] pointed out their preference for further requirements on disclosure, which could contribute to making informed decisions on how pay and performance are linked.

When it comes to assessing the benefits of disclosing individual remuneration, *FSS Korea* (which only requires the disclosure of individual remunerations if the amount exceeds an established ceiling) highlights that if the remuneration of individual board members is disclosed, companies might be encouraged to use objective and sensible standards to determine the level of remuneration, thereby preventing the arbitrary intervention of controlling shareholders[128].

The *ICGN* highlighted that caution is needed with such requirements, and *SVS Chile* stated that the benefits of disclosing individual amounts of remuneration are unclear, given the need to protect personal data and company strategic information.

The survey results revealed preference for remuneration to be disclosed on an aggregate basis, by corporate body[129], reflecting a slight prevalence of regulatory frameworks and views leading to a non-mandatory disclosure of individual compensation, as most entities indicated. *SEC Pakistan* requires the disclosure of aggregate remuneration, but stated that the separation of individual remuneration should be kept voluntary.

There are alternative regulatory requirements, recommendations and approaches, as follows:

(i) *Argentina*: companies, while preserving confidentiality, must disclose the individual board members' remuneration to CNV;

(ii) *Brazil*: companies must also disclose the minimum, the maximum and the average individual amounts paid within main corporate bodies in the last 3 financial years[130];

(iii) *India*: listed companies are required to disclose the ratio of each director to the median employee's remuneration;

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126 Russian Corporate Governance Code recommends the description of the system of remuneration as well as a detailed amount of individual remuneration payable upon performance indicators and results. The Bank of Russia points out that obligatory disclosure is currently being debated.

127 Schroders, Aberdeen and Saudi NCB Capital.

128 Another relaxing requirement was reported by SEC Thailand, which requires the disclosure of the remuneration of executives in an aggregate basis, while the remuneration of the board should be kept at individual level, being disclosed with description of each board position and committees involved.

129 SEC Pakistan, SEBI India, CNBV Mexico, CNV Argentina, SEC Trinidad and Tobago, Corporate Governance and Capital Market Centre of the University of Chile, Russia AII, Russia PJSC "Severstal", Russia MegaFon PJSC, Saudi Aldrees Petroleum & Transport Services Co.

130 As pointed out by Brazil AMEC, the question is controversial, while some Brazilian companies got injunctions against this rule, allowing them to disclose only aggregate information.

(iv) *South Korea*: the exact amount and detailed components of individual remuneration have to be disclosed if exceeds a given threshold[131]; and

(v) *Israel*: individual disclosure is only required for the top 5 officers with the highest compensation[132].

Table IV.B.4. Summary of responses regarding disclosure of policies and individual compensation:

Most GEM regulators have requirements in place for the disclosure of executive and board compensation policies, specifying their components and how they are linked to company performance and long-term strategic goals. With respect to the disclosure of remuneration paid, although it is a controversial topic, most jurisdictions require or recommend disclosure on an aggregate (by corporate body) instead of an individual basis.

b.5) Balance between variable and fixed remuneration

The OECD Principles recommend that the interest of shareholders should be considered in linking remuneration and the company's performance, which leads to the different forms of say-on-pay[133], which play an important role in conveying shareholder sentiment to the board.

Respondents of the CGTF Questionnaire were asked to provide their perspective on the components of the compensation structures, including the expected balance between variable and fixed remuneration. In addition, they were also invited to indicate whether the regulator should interfere in the designing of such balance.

26 GEM regulators have expressly provided their views on this matter, which can be classified as follows:

(i) Regulators should not interfere and the company should determine its own remuneration system[134]. This was the view of eleven (11) regulators[135];

131 KRW500 million.

132 This approach is advocated by the CFA Institute and was also cited by Saudi (NCB Capital, United Electronics) and Russian (PJSC "Inter RAO") entities.

133 I.e., binding or advisory vote, ex ante and/or ex post, board members and/or key executives covered, individual and/or aggregate compensation, compensation policy and/or actual remuneration.

134 Brazil ABRASCA and Brazil BM&FBOVESPA highlighted that the compensation structure must be oriented toward sustainable growth of the enterprise. In this sense, compensation elements should comprise fixed and variable elements, and the board must assure that the variable compensation elements are in general based on a multi-years assessment.

135 Dubai FSA, CMB Turkey, CSRC China, Egypt FSA, The Bank of Russia, SEC Thailand, NBFIRA Botswana, SSC Vietnam, HANFA Croatia, SV Dominican Republic and Panama SMV.

In Thailand, it is also left at the discretion of the board to determine an appropriate mix of the board remuneration corresponding to the operating performance and characteristics of each company.

(ii) Regulators should set a balance between variable remuneration/bonus compared to fixed remuneration. This was the view of eleven (11) regulators[136]. Four (4) of them[137] stated that regulators should provide guidelines for variable remuneration, some requiring to have a sensible ratio of fixed and variable remuneration based on the seniority of the executive and the level of risk assumed; and

(iii) No specific provisions requiring the setting of a balance between variable remuneration/bonus compared to fixed remuneration for listed companies. This was the case for four (4) regulators[138].

<u>Table IV.B.5. Summary of responses regarding balance between fixed and variable remuneration</u>:

There are divergent views on whether regulators should or not interfere with the setting of a balance between fixed and variable remuneration.

b.6) Regulatory requirements - pay for performance

The OECD Principles recommend the alignment of key executive and board remuneration with the longer term interests of the company and its shareholders. In this sense, the OECD Principles mention that the remuneration policy statement should specify the relationship between remuneration and performance, including measurable standards that prioritize longer run interests of the company over short term considerations.

The introduction of *malus* and claw-back provisions is considered a good practice because they grant the company the right to withhold and recover compensation from executives in cases of underperformance, managerial fraud and other forms of malpractice.

26 GEM regulators expressed their opinion on whether regulators should establish measures requiring companies to implement remuneration policies linked to corporate and or individual performance, taking into account transparent and easily comparable measure of performances – i.e. pay for performances. The answers are grouped as follows:

(i) Remuneration policies should be linked to corporate/individual performance by measuring pay for performance[139]. This view was held by 14 regulators[140];

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136 SEBI India, SCA United Arab Emirates, MNB Hungary, KNF Poland, FSS Korea, SEC Trinidad and Tobago, Romania FSA, FSB South Africa, CMF Tunisia, SEC Pakistan and FSC Chinese Taipei.

137 SEC Pakistan, SCA United Arab Emirates, MNB Hungary and FSC Chinese Taipei. In Chinese Taipei, the remuneration committees of listed companies are required to prescribe and periodically review the performance review and remuneration policy, system, standards, and structure for directors, supervisors and managerial officers, and periodically evaluate and prescribe the remuneration of individual directors, supervisors, and managerial officers in accordance with Article 7 of the Regulations Governing the Appointment and Exercise of Powers by the Remuneration Committee of a Company Whose Stock is Listed on the Stock Exchange or Traded Over the Counter.

138 CMF Tunisia, CNBV Mexico and SSF El Salvador.

139 Key performance indicators are categorised into corporate KPIs and individual KPIs.

(ii) Remuneration policies should be determined by companies individually and should not be regulated by laws and regulators. This was the view of nine regulators[141]; and

(iii) In three jurisdictions (*Mauritius*, *Romania* and *Israel*), regulators have mandated each company to specify in its by-laws the method of remunerating its board of directors[142].

Table IV.B.6. Summary of responses regarding pay for performance:

Respondents considered it appropriate to set remuneration policies linked to corporate and/or individual performance. However, responses seem to favor allowing companies to determine their remuneration policies and associated performance indicators.

C) Key takeaways

Based on the views and practices reported by respondents of the CGTF Questionnaire, the CGTF provides the following takeaways to be considered by emerging market regulators:

IV.C.1) Regulators should require companies to disclose compensation policies, the detailed components of existing remuneration plans (including bonuses, rewards, stock options), and how variable criteria are linked to the company's short, mid and long goals. Disclosure should comprise pensions, termination and end-employment contracts, including the total amount as well as the rationale for payment.

IV.C.2) Shareholders should have the ability to express their opinion on remuneration policies, including any equity-based compensation plans.

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140 The Bank of Russia, SEC Pakistan, FSB South Africa, CNBV Mexico, FSC Chinese Taipei, SSC Vietnam, SEBI India, SCA United Arab Emirates, CMB Turkey, NBFIRA Botswana, SV Dominican Republic, FSS Korea, SC Malaysia and SEC Thailand. As a reference, the Mexican Code of Best Corporate Practices in Practice 40-VI, recommends for all firms – not only to listed companies - that the board, when assessing the remuneration policy for the general director and senior officers, consider their previously agreed goals as well as their individual performance and firm's financial condition.

141 CNV Argentina, KNF Poland, HANFA Croatia, CMF Tunisia, Dubai FSA, CMA Saudi Arabia, Egypt FSA, Panama SMV, SEC Trinidad and Tobago. In the same sense, Schroders, Aberdeen, UAE Hawkamah, Argentina MAE, Argentina BBVA, Brazil ABRASCA, Brazil BM&FBOVESPA, Russian entities (PJSC Rostelecom, PJSC "Severstal", MegaFon PJSC) and Saudi entities (Aldrees, Eastern Province, Jadwa and Kayan).

142 For example, FSC Mauritius requires companies to issue a transparent "Statement of Remuneration Philosophy" in their annual financial statements so that shareholders and stakeholders can comprehend the board's policy and motivation in determining remuneration for directors in accordance with specified benchmarks. Romanian listed companies, on the other hand, are required, by the BVB Governance Code, to distinguish the awards granted during the year under review from awards that were vested during the year before, if any. Finally, a third case, reported by ISA Israel, concerns a legal requirement for the board to adopt the remuneration policy after considering several different components, including the contribution of the company's officers.

IV.C.3) Regulators should promote board's responsibility for assuring the alignment of key executive remuneration with company's long-term performance and business continuity to ensure the company is not exposed to undesirable risks in the name of immediate returns.

IV.C.4) The establishment of specialized subcommittees in charge of remuneration matters should take into account the company's size and industry sector, in order to avoid excessive regulatory costs. If established, these subcommittees should be entirely, or at least mostly, composed of independent non-executive members of the board of directors, and chaired by an independent director.

IV.C.5) Setting compensation policies linked to corporate and or individual performance ("*pay for performance*") is desirable, and the board of directors (or nomination and/or remuneration subcommittee, as the case may be) should define the indicators, without prejudice of the disclosure requirements referred in item IV.C.1 above. And

IV.C.6) There is no consensus or clear common references on whether regulators should establish requirements concerning the balance between variable and fixed remuneration. Companies should be in charge of defining such parameters, in accordance with its characteristics and needs, without prejudice of ulterior verification of responsibilities for breaches of fiduciary duties.

V. RISK MANAGEMENT AND INTERNAL CONTROLS

The outbreak of accounting scandals in the 1990s highlighted the need for the development of a coherent framework (including proper systems of control and policies) to identify, measure, mitigate and disclose risks. This has gained increasing importance in the debates on corporate governance.

However, despite considerable progress, the global financial crisis of 2008 put corporate governance in the spotlight once again. As it became clear after the events, weaknesses in risk management structures, although not being the trigger of the crisis, contributed to its occurrence and the damage caused by it.

This led financial market stakeholders to reflect on their roles and how to make corporate governance more effective. From a capital market perspective, the post-crisis review has shown risk management to be a fundamental pillar of a resilient corporate governance framework.

Establishing appropriate risk management frameworks and internal control systems is a complicated and challenging issue. As the global financial crisis revealed, it requires an understanding of both macro-prudential and micro-prudential risks (i.e. an understanding of how the company can be put at risk by systemic problems as well as by its own unique sources of risk).

Codes, committees, and requirements are not enough to properly deal with this challenge in the absence of a real risk management culture that is fully incorporated in a company’s day to day operations.

If the efforts to implement a risk management culture are limited to a few selected risk managers within an organization, those efforts will most likely fail.

There are different views on what constitutes the essence of risk management, which may be consequence of some misconception or poor understanding about the differences among **risk management**, **internal controls** and **compliance**. For the purpose of this Report, these concepts may be defined as follows[143].

Compliance may be defined as the adherence to applicable legislation, rules, regulation and previously established procedures, including the company’s efforts to ensure that its executives, officers, employees and other collaborators do not breach such norms and procedures.

Internal controls* and *risk management may be understood as overlapping systems. In other words, not all activities covered by internal controls functions are related to risks, and not all controlling of material risks can be covered by internal control systems.

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143 Reference is made to the paper produced by the Office of Risk and Research of CVM Brazil on October 2015: “Gerenciamento de riscos corporativos: uma análise das diretrizes e das práticas”. Available on http://www.cvm.gov.br/menu/acesso_informacao/serieshist/estudos/estudos.html.

Internal controls are intended to ensure fulfillment of corporate's goals. They also ensure an efficient deployment of corporate resources and assets, avoiding and mitigating operational deviations that could affect business continuity and the achievement of company's goals.

Risk management, on the other hand, is more holistic. Not only does it comprise operational procedures, but also the company's strategic guidance, including company's external environment and reputation. It requires defining the company's exposure to such risks (the "risk-appetite"), including their identification, measurement, evaluation, treatment and mitigation[144].

The outputs of risk assessments should provide the board and management with a realistic perspective of material risks facing the company, and emerging risks should be timely incorporated and assessed, through a recognized methodology[145].

Risk management is not just a matter of business competitiveness, but business and market safety and sustainability. Therefore, accurate and efficient risk management and internal control practices have the ability to reflect and promote a sound business environment. The greater sophistication and complexity of modern business have also significantly affected the way in which management implements key decisions. They demand a new approach, recognizing risks may build up rapidly and create contagion within the company or beyond.

From a regulatory perspective, it is fundamental to address four major issues:

(i) What should the regulatory disclosure requirements cover regarding internal controls systems and risk management policies? How can regulators make sure information disclosed is regular, reliable, accurate, and comparable, allowing shareholders and potential investors to make informed decisions?

(ii) How far should regulators go beyond requiring disclosure without creating excessive and unnecessary costs?

(iii) How should regulators promote and oversee an independent, efficient and accountable board performance, given that the establishment, assessment and review of effective and integrated internal controls and risk management systems are key functions of the board?

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144 Although the word "risk" may evoke a pejorative connotation, risks, per se, are not undesirable, but inherent to business activities and value creation. This is why risks factors must be identified, understood in their entire dimension, properly managed and, when relevant, communicated to the market.

Actually, regulators cannot miss the perspective that a proper risk management policy may even raise a company's risk-appetite. In other words, a higher risk-taking appetite does not necessarily represent a worse performance of the company, as long as such policy (i) is aligned with the fulfillment of the corporate purpose, (ii) does not endanger the sustainability of the business in the long-run, and (iii) is fully discussed and disclosed to investors and monitored on a continuous basis.

145 This process should take into account, inter alia, stakeholder risk, reputational risk, compliance risk, ethics risk and operational risk.

(iv) How can regulators help create a real risk culture within companies, ensuring board and top management to assume their key responsibilities, putting in place, not just systems and policies, but also the right incentives and drivers of behavior, given that a rules-based compliance approach alone has been proven to be inefficient?

Regulators and policymakers, particularly in emerging markets, should perform a proactive role in strengthening corporate governance structures, bringing to life recognized standards, promoting and prioritizing this discussion across companies, bearing in mind the significant and potentially systemic impact caused by fragile internal controls, inappropriate policies and weak risk management cultures.

A. Relevant OECD Principles

The OECD Principles highlight the importance of risk management and effective internal controls to a proper corporate governance system from two main perspectives:

(i) within the disclosure and transparency standards (Principle V – Disclosure and Transparency[146]; and

(ii) within the board's key functions (Principle VI – Responsibilities of the Board[147]).

a.1) Disclosure and Transparency

The OECD Principles focus on the importance of a high quality financial and non-financial reporting[148], while recommending companies to disclose all material information related to:

(i) financial and operating results;

(ii) company's objectives and non-financial information;

(iii) major share ownership (interest);

146 The emphasis on disclosure and transparency standards is based on the assessment that capital markets are built on confidence and trust, and poor transparency may give rise to malpractice in the corporate environment, undermining market integrity, efficiency and fairness.

An adequate disclosure system is essential for the equitable treatment of shareholders and potential investors, providing them with the needed inputs to take informed decisions, reflecting their risk profile.

147 It is recognized that the board of directors plays a "leadership role" within the organization in terms of ensuring sound practices, translated into proper and efficient mechanisms and policies able to monitor and manage risks, as well as the integrity of company's reporting. Principle D of Chapter VI describes as one of the key functions of the board: "(…) *7. Ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards."*

148 Chapter V, Principle B: "*Information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial reporting*".

(iv) remuneration schemes of board members and key executives;

(v) selection process and qualifications of board members and key executives;

(vi) related party transactions;

(vii) foreseeable risk factors;

(viii) issues regarding employees and other stakeholders; and

(ix) governance structures and policies[149].

In order to promote high quality reporting regarding financial position and performance of the company, it is also recommended an annual audit conducted by an independent and qualified auditor[150], who must provide its opinion on the quality of company's controls and procedures[151].

Disclosure of information on risk monitoring and managing systems is also referred to as an increasingly reputable good practice[152].

a.2) Key functions of the board in this matter

Among other core functions, the board is deemed responsible for the:

(i) establishment, oversight and continuous review of internal control systems, making sure there are clear lines of accountability for management[153];

(ii) permanent monitoring and periodical reassessment of company's governance practices[154]; and

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149 Chapter V, Principle A.

150 The OECD Principles also acknowledge the practice, observed in some jurisdictions, that requires external auditors to report on company's controls (Chapter V, Principle C), reinforcing the view that external auditors may and shall play a relevant role in the improvement of corporate governance environment.

Given this role, and in order to improve audit quality, it is absolutely essential to have external auditors effectively (i) accountable to the shareholders, and (ii) independent. To achieve independence, the OECD considers a good practice for external auditors to be recommended by an independent audit committee of the board (or an equivalent body), and to be appointed by either that body or by shareholders, directly.

Accordingly, IOSCO has already emphasized, in the *Principles of Auditor Independence and the Role of Corporate Governance in Monitoring an Auditor's Independence*, that auditor independence standards should address at least the following threats: self-interest, self-review, advocacy, familiarity and intimidation.

151 Chapter V, Principle C.

152 Chapter V, Principle A, Item 7.

153 Chapter VI, Principle D, Item 6.

154 Chapter VI, Principle D, Item 2.

(iii) guidance and review of risk management policies and procedures[155].

In order to do this effectively, the board is expected to:

(i) provide up-to-date guidelines for management, prescribing how existing and created risks must be managed to achieve company's targeted risk profile, and

(ii) define accountabilities and responsibilities for corporate bodies and existent committees[156].

B. Analysis of survey results

The majority of respondents has established material requirements concerning the disclosure of internal control systems and risk management policies, and has highlighted the prominent role of the board in this matter.

The following issues were covered in the CGTF Questionnaire:

(i) disclosure and transparency requirements concerning internal controls systems, risk management policies and risk factors that may affect company operations and business sustainability;

(ii) requirements concerning the companies' structure regarding risk management, internal controls and compliance, as well as the content, evaluation, reassessment and review of structures, systems and policies;

(iii) the leading role of the board in (i) establishing and assessing internal controls and (ii) providing guidance regarding risk-appetite; and

(iv) how regulators should use information produced by auditors better to enhance companies' internal structures and policies.

b.1) Disclosure requirements

Capital markets are built on confidence and trust, so an adequate disclosure system of "material information" is absolutely critical for investors to take informed decisions that

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155 Chapter VI, Principle D, Item 1. The board is entrusted to specify and oversee the risk factors and level of risk the company is willing to accept in the pursuit of its goals and objectives.

156 In this regard, Chapter VI, Principle E, Item 2 of the OECD Principles asserts that the board should establish specialized subcommittees for audit in particular, as well as risk management, in order to enhance its performance of key functions. The OECD also highlights that audit committees should oversee the integrity and effectiveness of internal control systems, by providing independent supervision of the overall relationship between the company and its external auditors. In practical terms, the establishment of other committees may also be subject to (i) local requirements and recommendations and, (ii) the assessment, by the board, of the company characteristics and needs. With respect to risk management, for instance, as examined in item V.B below, some jurisdictions require the establishment of risk committees, based on criteria such as market cap or market segment.

match their risk profile, expectations and even other personal beliefs that may affect their decision-making process.

The OECD Principles recommend the disclosure of all *"material information"* related to:

(i) foreseeable risk factors; and

(ii) governance structures and policies.

The reference to "material information"[157] assumes that disclosure should be made on relevant information that matters to shareholders. In other words, companies should disclose, on a periodic basis, sufficient and updated information for investors to make judgments, at first, on the risk factors that the company faces, and, secondly, on the quality and appropriateness of internal controls, risk management and compliance processes, which should reflect sound business practices[158].

What is deemed to be relevant information naturally varies from jurisdiction to jurisdiction, but the responses to the CGTF Questionnaire indicate a core on which the majority of requirements provided by regulatory frameworks is built on.

b.1.1.) Risk Factors

The risk exposure of companies is not limited to financial risks. It includes a number of elements, such as reputational, operational, human resources, business continuity, innovation, compliance, environmental, social and cyber risks[159].

These risks should also be disclosed to investors in full, in line with the abovementioned concept of "materiality". Companies often forget this, adopting *pro forma* or "defensive" approaches, driven either by the need to fulfill the risk disclosure requirements or by excessive caution, in order to protect themselves against subsequent claims for lack of disclosure. Such companies usually list a large number of risks, including some that are remotely associated to their daily business or which have minor impact.

To prevent the disclosure of immaterial risks, Brazilian publicly-held companies are required to disclose only the main risk factors that may affect the company and investment decisions[160]. Reference to material or principal risks was also made by respondents as the *ICGN*, *CNBV Mexico, FSA Romania* and *SEC Thailand*. *Aberdeen Asset Management*, in this respect, highlighted that companies should articulate no more than 10 major risks (considering their business and strategies), outlining how they are mitigated and managed.

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157 Too much information, also in this case, represents misinformation.

158 Dubai FSA, for instance, requires the board to disclose, in its annual report, a summary of policies and procedures in place for the identification, oversight and management of material business risks.

159 These areas were reported, in essence, by FSC Mauritius, which provided their views on the essential areas of risk that companies should report, consider and take appropriate action.

160 CVM Instruction No. 480/2009, as amended by CVM Instruction No. 552/2014.

Disclosure should be the result of a suitable methodology for identifying and assessing risks, which clearly reflects the updated and continually reassessed focus and priorities of the company's risk management policies and procedures.

Focusing on those risks that really should be addressed is not only important for disclosure purposes, but it also allows an on-going internal reflection and reassessment concerning priorities established in the risk policy and procedures.

Table V.B.1.1. Summary of responses regarding disclosure on risk factors:

Disclosure should comprise material risks that could effectively affect the company. Thus, regulators should refuse pro forma disclosure, or the simple listing of too many risk factors, including immaterial or irrelevant ones.

b.1.1.1) Cyber, sustainability and social risks

Given the diversity of risks that may affect companies and how they may vary depending on the jurisdiction, segment, scale and unique levels of corporate exposure, respondents were encouraged to express their views on what they believe should be the approach of regulators concerning:

(i) cyber and information security risks, and

(ii) sustainability and social responsibility risks, as well as integrated reporting.

In both cases, the inputs provided reveal a diverse set of views.

With respect to the role regulators should play concerning cyber risks and data integrity, the CGTF received the responses of 27 GEM regulators.

The potential magnitude and relevance of cyber security risks were widely cited, and some respondents even highlighted how they could lead to market failure and even pose systemic risks[161]. In this sense, the board´s responsibility and accountability for oversight and management was the subject of many of these answers.

Two different proposed approaches were adopted as to how such risks should be reported. The first view has a slight majority over the second:

(i) seven regulators[162] expressed the opinion that the board is already responsible for overall risk management, in which cyber risks are included. For that reason, there was no need for standalone reporting requirements, and these risks should be measured according to the business model and strategy of the company, integrating standard risk reporting. To promote awareness and highlight the importance of managing trending risks, it is worth mentioning the

161 For instance, the ICGN and NBFIRA Botswana.

162 ISA Israel, SEC Thailand, SMV Panama, Dubai FSA, SEBI India, FSB South Africa and CMA Saudi Arabia.

initiative of *Bursa Malaysia*, which has been emphasizing cyber security risks in its Risk Management and Internal Control programs for audit committees (with particular attention to small and medium-sized listed issuers)[163]; and

(ii) five regulators[164] demonstrated a different view, indicating that the board should disclose specific reports concerning this matter. *Schroders* argued that the systematic publication of activity reports concerning cyber security and data integrity would be welcomed, considering (a) the potentially significant costs deriving from data insecurity and vulnerability, and (b) that a mandatory requirement could help place a much-needed emphasis on the issue, helping investors gauge how well companies are building their businesses to be more resilient to cyber risks[165].

The remaining 15 regulators presented the following comments:

(i) seven regulators[166] pointed out the absence of obligatory requirements in this regard[167] or highlighted that this issue should be left at the company's discretion[168];

(ii) two regulators[169] acknowledged the increasing importance of addressing cyber risks, emphasizing that regulators should promote recommendations instead of imposing requirements in this matter. *FSS Korea* highlighted that the board should play a bigger role in dealing with cyber and information security. *SEC Trinidad and Tobago*, in turn, pointed out that regulators should consider that

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163 Similar point of view was reported by SEC Thailand, which requires that cyber and information security and data integrity be part of internal control system and be integrated within the same report. Accordingly, it should also be in the interest and responsibility of audit committee to monitor any associated risks and the effectiveness of the system in a company. This is because cyber risk is considered to be a new emerging trend that can affect overall risk management and internal control of a company.

164 SSC Vietnam, CMB Turkey, SCA United Arab Emirates, FSC Mauritius and NBFIRA Botswana, in addition to Schoreders, JS Company R.O.S.T. Registrar, Sberbank of Russia, Brazilian ABRASCA, UAE Hawkamah, Saudi Arabia Stock Exchange (Tadawul), NBC Capital, Aldrees Petroleum & Transport Services Co., Eastern Province Cement Company and Yamanah Cement Company,.

165 Additionally, *FSC Mauritius*, when pointing out the board responsibility for information security and IT governance, also noted the possible participation of a risk committee or an audit committee in the establishment and review of this framework.

166 CSRC China, The Bank of Russia, SVS Chile, SV Dominican Republic, CMC Angola, KNF Poland and CNBV Mexico, in addition to Russia VTB Bank JSC, Russia PJSC Norilsk Nickel and Saudi Savola.

167 CSRC China and CNBV Mexico pointed there is no obligatory requirement in their respective jurisdictions. KNF Poland and PJSC Norilsk Nickel expressed their view that it should not be a mandatory requirement, SVS Chile, in the same sense, affirmed that, so far, does not identify any benefits of mandatorily requiring the incorporation of practices or reports related to this matter, and Saudi Savola asserted that the threats and risks of making it mandatory should be further understood.

168 The Bank of Russia and VTB Bank JSC.

169 FSS Korea, SEC Trinidad and Tobago, in addition to Oman Center for Governance and Sustainability, Russian NSD, PJSC Rostelecom and MegaFon PJSC.

many companies do not use sophisticated IT systems to conduct their operation, which is why imposing such requirements might be restrictive[170];

(iii) two regulators expressed their views that such requirements should be restricted to certain sectors, notably financial institutions[171];

(iv) three other regulators[172] said that neither mandatory disclosure requirements nor public reports should exist, but companies should establish internal control procedures and the board should be aware of all material information on security aspects that may represent business risks; and

(v) one regulator[173] pointed out the theme is under discussion in the respective jurisdiction, where there is a project aiming to require the disclosure of the main aspects of cyber security as part of the company operational risks.

Although the inputs reveal different approaches regarding how cyber risks should be addressed, it is clear that such risks have been receiving increasing attention from GEM regulators. Only 12 among all respondents indicated the absence of regulatory requirements or indicated that this issue should be left at company's discretion.

Table V.B.1.1.1. Summary of responses regarding cyber risks:

Responses suggest that it is important to consider and review cyber risks, but there is no consensus on whether they should be disclosed via a standalone reporting.

With respect to eventual mandatory regulatory requirements on integrated reporting, including the disclosure of social responsibilities and environmental/sustainability issues, there were responses from 31 GEM regulators. Most of the respondents highlighted the importance of disclosing risks related to social and sustainability issues, although, once again, through different approaches[174]:

170 Other entities, as CG Center of Catholic University of Chile and Russian PJSC Rostelecom, understand that this disclosure should be voluntary, driven by its potential benefits, as additional competitive advantages.

171 For MNB Hungary, financial service providers shall have internal rules on IT security, and there is a general requirement concerning financial institutions that provides the need to issuing an IT assessment report. Egypt FSA, on the other hand, asserts that regulators should require a section in the annual report with regards cyber security and data integrity just for companies of certain sectors (financial services and telecom). In addition, Argentina BBVA points out that banks should have an IT committee. Lastly, Russian Association of Institutional Investors understands that this requirement should be focused on businesses where information security plays a crucial role, like banks, financial companies, e-commerce and companies that work with large amount of personal data.

172 FSC Chinese Taipei, FSA Romania and HANFA Croatia.

173 SSF El Salvador.

174 Among the regulators, just *KNF Poland* and *SEC Trinidad and Tobago* did not considered the need of having mandatory requirements concerning integrated reporting, addressing sustainability and social responsibility. SEC Trinidad and Tobago highlighted that the establishment of requirements in this area could find practical hurdles, inclusively in terms of regulatory costs.

(i) eleven regulators[175] expressed their views regarding the benefits arising from mandatory requirements of integrated reporting. As stated by *SVS Chile*, integrated reporting is a relevant source of information provided to the general public. According to *FSB South Africa*, integrated reporting allows investors to access information across all areas of performance, including economic, social and environmental issues, and ultimately reflecting the choices made in the strategic decisions made by the board[176]. *Schroders* emphasized that additional transparency on Environmental Social and Governance (ESG) benefits investors' understanding related to risks and opportunities faced by companies, and how these companies are responding to such challenges[177]. It is worth mentioning the approach applied in *Argentina*, where *CNV* requires companies to specify rules or initiatives that have been taken to implement its corporate social responsibility policy, such as the Global Reporting Initiative – GRI[178]. This approach is similar to that proposed by *FSC Chinese Taipei* and *SEC Thailand*, which require listed companies to compile sustainability reports based on GRI G4 Sustainability Reporting Guidelines in order to disclose ESG information and promote the value of sustainability and social responsibility. *SEBI India* adopts a market capitalization criterion[179], requiring just the top 500 companies to prepare a business responsibility report, describing initiatives taken from an environmental, social and governance perspective;

(ii) nine regulators[180] argued that this should be encouraged, but not necessarily required in the regulatory framework. *The Bank of Russia*, *CMA Saudi Arabia*, *FSA Romania* and *CMB Turkey* pointed out recommendations in their frameworks under which policies in social and environmental spheres shall be disclosed[181]. *Dubai FSA* and *FSC Mauritius* are of the view the disclosure of

175 FSB South Africa, Egypt FSA, CNV Argentina, NBFIRA Botswana, SVS Chile, SEC Pakistan, CMF Tunisia, FSC Chinese Taipei, and SEBI India.

176 FSB South Africa also pointed out that integrated sustainability may be delegated by the board to a specific committee (risk, sustainability or audit).

177 In Malaysia, listed companies are required to disclose a Sustainability Statement, narrating how they manage material economic, environmental and social risks and opportunities.

178 In accordance with their own definition, available on www.globalreporting.org, Global Reporting Initiative – GRI is an international independent organization that helps businesses, governments and other organizations understand and communicate the impact of business on critical sustainability issues such as climate change, human rights and corruption.

179 SEBI India also adopts a market capitalization criterion in the establishment of requirements concerning the definition of what companies should have a risk committee, as analyzed in item V.C.3 below.

180 CSRC China, The Bank of Russia, CMA Saudi Arabia, FSC Mauritius, Dubai FSA, FSS Korea, CMB Turkey, HANFA Croatia and FSA Romania.

181 In Russia, the Corporate Governance Code recommends the disclosure of policies in social sphere and the report of the company on sustainable development. On the other hand, CMA Saudi Arabia and CMB Turkey require such disclosure through comply or explain basis. Additionally, in Turkey, as reported by CMB, there is an index on Borsa Istanbul (BIST Sustainability) based on the disclosure made by listed companies concerning their environmental and social policies, aiming to provide a benchmark to increase awareness, knowledge and practice on sustainability.

these policies should not be mandatory, but voluntary, as a result of the interaction of companies and stakeholders (who should naturally demand this information)[182]. In turn, *FSC Mauritius* pointed out that every company should recognize that they operate within a social and economic community, identifying and reporting particular circumstances, whether environmental or social, relevant to company's business. The *ICGN* argued that integrated reporting, putting historical performance into context, portraying the risks, opportunities and prospects for the company future, would help investors and stakeholders to understand company's strategic objectives and its progress towards meeting them;

(iii) three regulators[183] considered sustainability and social responsibility as key factors to be disclosed as part of the annual report, whereas the board is already responsible for the management and treatment of material risks faced by the company[184]; and

(iv) two regulators[185], on the other hand, made reference to specific disclosure requirements concerning environmental and sustainability risks. Israeli companies are required, by law, to report on the environmental risks that may affect their operations, and the steps taken to manage these risks. Mexican listed companies, in turn, are required to disclose if they have an environmental policy, and the significant environmental risks posed by their activities as well, including externalities arising from climate change.

Table V.B.1.1.2. Summary of responses regarding need for integrated reporting:

There is a prevailing awareness of the benefits and importance of integrated reporting addressing sustainability, environmental and social issues. Nonetheless, there are different perspectives concerning its implementation, particularly regarding the establishment of mandatory requirements, given different drivers to encourage integrated reporting (such as through recommendations or interactions with shareholders).

b.1.2) Policies and systems

The responses concerning what the disclosure requirements should be regarding policies and systems embrace, at first, the description of relevant internal control systems and of the risk management policies themselves.

182 Accordingly, T. Rowe Price has stated that a requirement would be premature, given the lack of standardized reporting protocols.

183 SMV Panama, SEC Thailand and SSC Vietnam. SV Dominican Republic only expressed the view that such report is part of the annual report of the companies.

184 SEC Thailand reported that the main concept around its requirement of Cyber Security Risks ("CSR") disclosure in company's annual disclosure document is the sustainability development of environment, social and governance of the company ("ESG"). This concept is required to be reflected in Thai companies' strategy, policy, and business day-to-day operation.

185 CNBV Mexico and ISA Israel.

In relation to **internal controls**, these processes should be designed to provide reasonable assurance regarding the achievement of objectives at least in the following ways: (i) effectiveness and efficiency of operations, (ii) reliability of financial reporting and (iii) compliance with applicable laws and regulations.

CMF Tunisia highlighted the importance of disclosing the corporate control environment, including existing control monitoring procedures, and the related information and communication activities. In a similar vein, in *Hungary*, financial institutions are required to annually disclose internal controls specifically on corporate and governance structure, bodies, committees, management and control functions, management of conflicts of interest, division of tasks and coordination of control functions. *CVM Brazil* requires companies to describe internal control practices and structures, including their efficiency, failures and measures adopted to repair imperfections[186].

The responses also reflect the prominent role of internal controls in assuring an accurate disclosure and proper reconciliation of financials and non-GAAP[187] financial measures, which allows a high level of credibility and comparability of data.

As referred by *CMA Kuwait*, this is one of the key ways of monitoring companies' activities and performance, contributing to improve the level of understanding by shareholders, investors and the public of the company, inclusively related to ethical standards.

Egypt FSA argued that financials give an incomplete view of the status of companies, preventing investors from getting the "complete picture" needed to make informed decisions about the allocation of their investments. This recognizes that non-financial internal and external factors affect business sustainability, and greater transparency in this field is likely to contribute to the long-term growth of companies and to reduce overall risks[188].

FSB South Africa and *Dubai FSA* stated that the board of directors should be satisfied with the integrity of information and that controls and systems of risk management are robust and effective.

Concerning **risk management policies**, *CNV Argentina* mentioned that the Argentinean Corporate Governance Code recommends describing relevant aspects of the policies, which

186 CVM Instruction No. 480/2009, as amended by CVM Instruction No. 552/2014. It is worth mentioning that, in Brazil, for beyond companies, internal controls of other market entities, as intermediaries, are also object of risk-based supervisions. Although referring to different entities and structures, what naturally demands suitable approaches, there is a core nucleus of necessary elements that should underlie both companies and intermediaries structures, as (i) the regular review and reassessment of the efficiency of such controls, (ii) the accountability of the responsible for their implementation, (iii) the focus on what should be prioritized and (iv) the need to embed compliance in daily activities.

187 Generally Accepted Accounting Principles.

188 Accordingly, Malaysian listed companies will be required, after December 31, 2016, to include a Management Discussion and Analysis in their annual reports to further improve the quality of non-financial reporting. Its prescribed minimum content should include an overview of the group's business and operations, including the review of operating activities, commentaries on identified anticipated and known risks (and mitigation plans), as well as forward-looking statement commenting possible trends of each of its principal business segments and prospects of new business or investments.

shall be established, monitored and updated by the board to address compliance with, among others, strategic, operational, financial, accountancy, laws and regulatory issues. Brazilian companies, in turn, are required to disclose risk management policies in place, revealing their objectives, strategies, appropriateness of operational structure and effectiveness[189]. In *Kuwait*, CMA Corporate Governance rules require the issuing of a risk and internal control report (annually submitted to the CMA and made available to shareholders). As referred by the *CFA Institute*, the board should clearly communicate the risk management process to investors in order to provide them with adequate information to judge for themselves whether the process of risk oversight is rigorous and being handled properly.

Where the board of directors is the corporate body in charge of designing and reviewing these systems and policies, there is a noticeable trend in requiring the assessment, by the board, of their effectiveness, efficiency and appropriateness, inclusively taking into account the size of the company and the type and scale of its activity[190]. It is worth mentioning that, by going further the mere description of internal controls and risk policies, such an assessment made by the board, analyzing their efficiency, not only provides a full and adequate disclosure of corporate structures, but allows the identification of failures, problems and how to solve them[191].

In a very significant number of jurisdictions the board is responsible for a periodical analysis of the design and operating effectiveness of internal controls and risk management practices[192]. This periodical analysis is usually required at least once a year, in the board annual report or equivalent document[193], but, as cited by *FSB South Africa*, it should reflect an on-going review process carried out by the board concerning internal structures and policies[194].

189 CVM Instruction No. 480/2009, as amended by CVM Instruction No. 552/2014.

190 As pointed out by KNF Poland. In the same sense, KNF Poland asserts that Polish listed companies, in accordance with the Best Practices of WSE Listed Companies 2016, should have separate units responsible for the performance of tasks in individual systems or functions in this process, unless the separation of units is not justified by the size or type of the company's activity.

191 Naturally, other benefits may arise from this self-assessment practice. FSS Korea indicates, for instance, that it may bring relevant subsidies to the supervision and evaluation of the performance of board members. After all, whereas the board should provide sufficient information for a well-informed decision of investors, what includes own board composition and qualifications, covering their competencies, expertise and risk management knowledge. In this process, the ICGN asserts the importance of an open communication, by the board, about any identified gaps in the board competence to the integrity of internal controls and appropriateness of risk policies.

192 In general terms, the survey results indicate that most of the respondents pointed out the existence (in respective jurisdictions), or stated the importance, of disclose board's opinion regarding the effectiveness of the systems and policies they are supposed to frame, implement, monitor and periodically review.

193 In accordance with the survey results, in at least the following jurisdictions there is a requirement of an annual-basis board report in this regard: SEBI India, CMB Turkey, SEC Thailand, CMA Saudi Arabia, FSA Romania, SEC Trinidad and Tobago, FSC Mauritius and SSC Vietnam. Some jurisdictions, however, require this disclosure in a shorter period, as the Bank of Russia disclosure regulation, which demands the disclosure of board assessment in quarterly reports.

194 In other words, it should not be deemed an annual one-off exercise by the board.

Accordingly, *Dubai FSA* stated that the need of having an adequate, effective, well-defined and integrated risk management, internal control and compliance framework, requires a periodical review and report, by the board, covering management, financial, operational and compliance controls and risk management systems.

FSC Mauritius, in turn, pointed out that the board statement on the risk management must include, as a minimum:

(a) the structures and processes in place for identifying and managing risks;

(b) the methods of integrating internal controls and risk management;

(c) the methods by which the directors assure risk management processes are in place and effective; and

(d) a brief description of key risks identified by the company and how they have been managed or mitigated.

The board annual report must also reflect that directors have carried out a robust assessment concerning the principal risks facing the company, including those that would threaten its business model, performance, solvency or liquidity.

In *Brazil*, CVM also requires companies to highlight any significant changes in the risk factors or in the policy focus, including the assessment and expectations regarding the increase or decrease in risk exposure[195].

As mentioned above and further detailed in item V.B.2 below, there is no doubt about the leading role of the board in this matter, which makes vital the statement of the board concerning the effectiveness and structures and policies.

The survey's results also revealed that some jurisdictions require disclosure of additional information which can contribute to the evaluation and assessment of companies' internal structures and policies – e.g. the disclosure of key findings of the audit committee[196].

Particularly with respect to risk management, on the other hand, it is worth mentioning that the definition, implementation, assessment and evaluation of related policies must take into account the risks that may be reasonably judged to affect the company and that investors should be aware of.

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195 SEC Thailand requires the disclosure of significant changes or incidents that may potentially impact the company's operation for additional review or assessment to be performed by both audit committee and board in order to exchange opinions and fine-tune their understandings so as to effectively prescribe the appropriate practices and direction for the company. Risk evaluation form under the concept of The Committee of Sponsoring Organizations of the Treadway Commission (COSO) is also provided for board and audit committee to assess together Thai company's internal controls and risk management on: (i) control environment, (ii) risk assessments, (iii) control activities, (iv) information and communication, and (v) monitoring activities.

196 Egypt FSA, FSS Korea and SEC Thailand. This last one also requires company to disclose report from audit committee as well as to specify the difference of opinion, if any.

There is no "one size fits all" process, and the board must be demonstrate judgment and accuracy in this process, considering elements like company scale, segment and market conditions while looking ahead for more efficient and sustainable ways to achieve corporate purpose and strategies[197].

Table V.B.1.2. Summary of responses regarding risk management policies and internal control systems:

There is significant awareness on the need for boards to go beyond just describing their systems and policies in their periodic disclosure, but also assessing their appropriateness and effectiveness.

b.2) Leading role of the board

Risk management includes the entire process involved in (i) identifying, (ii) assessing, (iii) monitoring, (iv) handling, and (v) taking appropriate action on the risk exposure in sensitive areas[198], in addition to reporting.

The role of the board in this process was also expressly highlighted by the majority of respondents. Some of the key duties include (i) to carefully establish and monitor the pillars for the internal control system (e.g., financial, compliance and policy controls), (ii) to define the company's risk profile, and (iii) to frame, implement and periodically assess the effectiveness of risk management policies[199].

The ultimate responsibility for ensuring the soundness of internal controls is with the board. This includes the establishment of specialized committees, such as the audit committee, which may be in charge of ascertaining that the internal control systems are adequate and effective[200], with the reporting structure including financial and operational controls, and accounting systems for timely and appropriate recording of purchases and sales, receipts and payments, assets and liabilities.

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197 In India, for instance, the Securities and Exchange Board requires the identification of risks that, in the opinion of the board of directors, may threaten the existence of the company.

198 Asked about the appropriateness of regulatory requirements concerning internal controls and risk management, KNF Poland and SEC Pakistan were the only securities regulators that responded that regulatory activity should be limited to the establishment of disclosure requirements.

199 Dubai FSA reported a significant enforcement action in which the company and the board of directors were deemed responsible for failures in governance, systems and controls in the ambit of the company and its subsidiaries. Besides the imposition of significant financial penalties (totalizing the amount of USD 3,700,000), the DFSA also required the company to implement several measures, including the establishment of effective internal audit and compliance functions, and the setting up of effective risk management systems and controls. In addition, SEC Thailand reported that the Board is also recommended to (i) review key business matters, including process of receiving complaints and procedures in handling cases that have indication of internal flaws or risks, (ii) assess the effectiveness whenever there is a change in risk level, (iii) focus on early warning signs and unusual transactions and (iv) give opinion on significant issues and adequacy of company's internal control and risk management systems.

200 SEC Pakistan.

In some jurisdictions[201] having an audit committee is a mandatory safeguard that should be in regular and direct communication with the board regarding the oversight of internal controls.

This structure is required for *Saudi* companies, through the CMA Corporate Governance Regulations and CMA Listing Rules, and in *Mexico*, where the boards of listed companies are expected to approve the guidelines on internal controls and be supported by the audit committee in surveillance activities. The Mexican regulatory framework states that the board should take into consideration periodic information provided by the audit committee, which shall update the board on the internal controls status, including any identified potential misconduct in transactions, guidelines, operative procedures and internal control systems[202].

CSRC China points out some other important features to be considered in the design of efficient internal controls, since, in China, the board of directors of listed companies is responsible for (i) setting up an information and communication system for timely communication, (ii) promoting the integration, sharing and communication of information through the use of information technology, and (iii) establishing anti-fraud, complaints, reporting and whistleblower protection mechanisms[203-204].

In the case of *FSC Chinese Taipei*, the primary basis for the board and general management to evaluate the overall efficacy of all internal control systems are: (i) the annual self-assessments conducted by all internal departments and subsidiaries[205], and (ii) the reports on the corrective actions of defects and irregularities found out by internal audit departments.

As per the company risk strategy, the board is responsible for deciding which risks will (or will not) be taken by the company in the fulfillment of corporate objectives, setting the parameters of the company's risk-appetite.

In doing this, *FSB South Africa* stated that the board should calculate the company's risk-bearing capacity and the tolerance limits for significant risks, and regularly discuss the resulting strategy, inclusively taking into account management suggestions in this regard[206] and consulting the supervisory board in its implementation[207].

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201 As further analyzed in item V.B.3 below.

202 It is relevant noting that in no event, the delegation to an audit committee may completely exempt the board of its fiduciary responsibilities, which make the board ultimately liable for eventual problems caused by poor internal controls or by excessive risk taking by managers, as stated by UAE Hawkamah. FSC Mauritius and SEC Thailand also acknowledge the possibility of the board delegate the implementation and monitoring of internal controls systems to management or sub-committees, as it may seems fit, but asserts that the board remains responsible for it.

203 The Corporate Governance Code of CNV Argentina also highlights the board responsibility for fraud prevention.

204 It is worth mentioning, in this sense, the Chapter IV, Principle E, of OECD Principles, which highlights that stakeholders, including individual employees and their representative bodies, should be able to freely communicate concerns about illegal or unethical practices to the board, without any reprisals or deprivation of rights.

205 Reviewed by its internal audit departments.

206 Therein, CMF Tunisia emphasizes that the definition of risk-appetite shall consider management suggestions and the internal risk management structure as well. HANFA Croatia, in turn, although

The board must implement a policy that includes an effective ongoing process to identify and measure risks and its consequences, and then implement what is necessary to manage these risks proactively. *SEC Pakistan* highlights that, in the design of this policy, all matters relating to risk management, including risk analysis, management and communication, should be placed for the information, consideration and decision of the board (or its relevant committee, if any).

In addition, *FSC Mauritius* stressed that it is a core responsibility of the board to communicate its risk policies to the management and all other employees by setting the authority limits of their roles within the organization and ensuring that this communication is truly effective and understood[208]. Accordingly, *SVS Chile*[209] reported that Chilean companies are required to inform and train their staff in the policies, procedures, controls and codes in place for risk management.

Creating an appropriate risk culture is a responsibility that the board must accept if it is to be truly effective in its core function of ensuring effective risk management. It is one of the most challenging missions for the board of directors[210], but it cannot be avoided. Lastly, it must be said that responsibility for risk oversight remains with the board even if it established a specialized committee[211], which may be a relevant tool to strength board's capacity in the oversight of corporate risks, favoring objective and independent decisions.

In other words, the board is ultimately responsible for implementing a strong and effective compliance and risk culture into the values of daily business activities, creating and reinforcing this culture in all levels of staff. The potentially damaging influences of a weak corporate culture and poor risk management were expressly highlighted by the *ICGN* as a material concern.

Table V.B.2. Summary of responses regarding the leading role of the board:

There is consensus that the board is the ultimately body responsible for the appropriateness and effectiveness of risk policies and internal controls.

Additionally, there is a prevailing view that risk management must be a priority in the board agenda.

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highlights the ultimate responsibility of the board, does not ignore the role of company's management in the identification, assessment, monitoring and management of risks, and in the development, operating and monitoring of internal systems, providing assurance to the board that it has done so.

207 MNB Hungary (financial institutions).

208 NBFIRA Botswana, in this line, refers to the existence of proper guidelines in place to ensure all staff members understand the controls aiming the reduction of non-compliance risks.

209 Provided by NCG No. 385, issued in June, 2015.

210 As a material example of bad governance, Russian company MegaFon PJSC has pointed out the poor development of risk culture among companies' employees, in virtue of lack of understanding of the risk culture.

211 Specialized subcommittees should have a supporting and not a substitutive nature regarding board functions. Accordingly, CMA Saudi Arabia mentioned a concrete case where the board unduly delegated its responsibility of approving the financial statements to audit committee.

b.3) Subcommittees

The OECD encourages boards to consider establishing specialized subcommittees with experts and sufficient resources[212], so they can enhance board performance in key functions.

Despite some opposing views[213], the survey's results indicate a clear trend to ensure the appropriate environment and structure within the company by requiring additional safeguards, such as establishing specialized subcommittees.

Among these committees, the OECD grants major emphasis to the audit committees, reinforcing the fact that they may play an important role:

(i) in the oversight of the integrity and effectiveness of internal controls,

(ii) assuring the quality of information produced by the company, and

(iii) contributing to the quality and independence of the work produced by external auditors.

23 out of 30 GEM regulators expressly referred to the establishment of audit committees as a mandatory requirement in their respective jurisdiction, or as a desirable regulatory measure that should take place[214].

The *ICGN* highlights the expectation that audit committees should be completely or at least mostly composed of independent directors[215]. According to *Schroders*, audit committees, which should be fully composed of independent members, may provide a great level of independent audit expertise for the company, while offering a sense of credibility for the investor[216].

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212 As stressed out by Dubai FSA, the resources include the necessary information to carry out their role and responsibilities effectively.

213 KNF Poland, Oman Center for Governance and Sustainability, Argentina MAE, Saudi Savola, PJSC Rostelecom, Megafon PJSC and PJSC Norilsk Nickel (Russia) indicated their views in the sense of regulators should focus their activity, in this field, in the establishment of disclosure requirements.

214 ISA Israel emphasizes that, although Israeli Companies Law requires the establishment of two different and separate committees – audit and compensation –, Israeli Regulations set more relaxed standards for SMEs. These companies are allowed to establish a single and consolidated committee, holding the authority of both, since audit committee's members comply with the more strict conditions of independence that are required to compensation committee.

215 The necessary independence of the audit committee was also emphasized, among others, by FSS Korea, The Bank of Russia, SEC Thailand, FSA Romania and FSB South Africa. On the other hand, there may exist some difficulties in assuring, in practice, an independent performance by such committees, as reported by SEC Bangladesh.

216 CMB Turkey highlighted, as a best practice, the introduction of an electronic disclosure system (Public Disclosure Platform), created in 2009. Through the platform, developed collectively by CMB, Borsa Istanbul and TUBITAK (The Scientific & Technological Research Council of Turkey), all Turkish listed companies are required to disclose their financial statements, explanatory notes, material events and other disclosures, including details regarding subcommittees and their members.

The scope of the audit committee's role naturally varies depending on the jurisdiction. It is also defined according to the mandate granted by the board, especially considering the perspective that regulators should just set the minimum accepted scope of these committees, including pointing out specific matters that should be within their remit[217]. The role of the audit committee is even more critical: (i) in assessing the appropriateness and effectiveness of internal controls, (ii) in verifying the soundness and integrity of reporting and (iii) in implementing risk management policies when there is no risk committee.

SC Malaysia highlighted that audit committees should be established to provide adequate oversight of the financial reporting process, the audit process and the system of internal controls[218]. Audit committees may also constitute a relevant tool to coordinate and improve the efficiency of internal and external audits[219]. In *Pakistan*, all listed companies shall first ensure that internal audit reports are submitted for review by the external auditors, and then that the external auditors shall discuss any major findings with the audit committee, which in turn shall report matters of significance to the board[220].

Regarding the establishment of risk subcommittees, 11 jurisdictions (out of 30)[221] identified the existence of requirements or recommendations[222]. The criteria vary from jurisdiction to jurisdiction, as it shown by the following examples:

El Salvador requires companies to have a risk committee[223], by law, if they access the securities market.

CNV Argentina, on the other hand, recommends the implementation of a Risk Management Committee within the board of directors, addressing the risk factors applicable to the company. Argentinean companies are also required to specify the degree of interaction between the board of directors (or its committees) and the CEO in reference to the risk

217 In India, for instance, the audit committee is in charge of previously approving all material related party transactions.

218 Further, SEC Thailand highlights the main responsibilities of the audit committee relating to internal control and risk management / assessment as follow: (i) to review the company's internal control system to ensure that they are suitable and efficient, (ii) to determine an internal audit unit's independence and approve the appointment, transfer and dismissal of the chief of an internal audit unit or any other unit in charge of an internal audit and (iii) to prepare and disclose in the company's annual report an audit committee's report consisting of opinions in many areas, one of which covers the adequacy of the company's internal control system.

219 CMB Turkey, SEC Thailand and CMA Saudi Arabia also highlighted the role of audit committees in the coordination between internal and external audit.

220 The role of external auditors is further detailed in item B.4.

221 Turkey, India, Mauritius, Hungary (financial institutions), Trinidad and Tobago, Egypt, Kuwait, El Salvador, Argentina, Chile and Dominican Republic. NBFIRA Botswana pointed out that, in their jurisdiction, smaller entities, which may not constitute audit subcommittees because of their size, the staff of such entity should have at least an internal auditor and a risk and compliance officer to ensure there is compliance to all board and regulatory requirements.

222 At least for part of the companies, in accordance with the criteria adopted by each jurisdiction.

223 "Comitê de Riesgo", by force of the "Norma para la Gestión Integral de Riesgo de Las Entidades del Mercado de Valores.

management. In addition, if there is no risk management committee, *CNV Argentina* requires the description of the supervisory role played by the audit committee in reference to risk management.

CMB Turkey highlights that listed companies should form a risk committee responsible: (i) for early detection of the risks that could pose a threat to business development and continuity; and (ii) for implementing the relevant respective measures with respect to detected risks.

SEBI India adopted a market capitalization criterion which requires the top 100 Indian companies to establish a Risk Management Committee. In such companies, the board of directors, which has to define the roles and responsibilities of these risk committees, may delegate the monitoring and reviewing of the risk management plan, as well as other functions that may be deemed appropriate[224].

FSC Mauritius requires companies that "*may be exposed to major risks*" to establish a "Board Risk Committee", composed of members with the proper skillset to review risk management processes. In addition, companies may form a risk committee, providing regular advice to the board on the total process of risk management in the company and to support the daily management of risk.

Other jurisdictions, such as *Hungary* and *Trinidad and Tobago*, set different rules to financial institutions[225]. In Hungary, the MNB Recommendations require financial institutions to have a risk policy and risk taking strategy, encouraging large and complex financial institutions to set up a risk management department or committee. In *Trinidad and Tobago*, banks and financial institutions are recommended to establish a separate Risk Oversight Committee, assessing the firm's exposure to credit, market, operational, compliance, legal, property, security, IT and reputational risks.

Table V.B.3. Summary of responses on specialized committees:

Most respondents appreciate the importance of having audit committees and consider that it should be a regulatory requirement.

Although there was no uniformity of views regarding risk committees, it is possible to conclude that any regulatory requirement concerning the establishment of risk management committees should take into account market characteristics, industry segments and company size. If establishing a risk management committee is not justified, the audit committee should be responsible for assessing the appropriateness and effectiveness of risk management policies.

b.4) External auditors

224 In the ambit of other Indian companies, the audit committee receives the onus for evaluating the adequacy of internal controls and risk management systems, as well as reviewing, with the management, the performance of internal auditors.

225 Egypt FSA stated that, in large financial services companies, a Risk Committee may also be mandated.

Given the critical role of external auditors as gatekeepers in strengthening the corporate control environment[226], survey respondents were asked to express their views concerning how regulators could make better use of information produced by external auditors. Quality audits are essential if they are to benefit for both investors and regulators, being the external auditors essential players in this process[227].

The *ICGN* stressed that regulators may help encourage the effectiveness of risk management systems by promoting joint work and the coordination of external audit, internal audit, risk management and compliance on behalf of an integrated assurance on risk to the board. *FSS Korea* asserted the importance of establishing a system that allows cooperation and information sharing between internal and external auditors[228]. *HANFA Croatia* stated that regulators should encourage active collaboration of all corporate governance participants (board of directors, audit committees, management, supervisory board, internal and external auditors), which should be deemed as fundamental to internal control success.

Furthermore, in line with the OECD Principles, which highlight the importance of external auditors' opinion in the audit statement to improve the control environment in the company[229], *SEC Pakistan* highlighted this role of external auditors and recommends auditors should discuss any major findings with the audit committee. *Dubai FSA*, in turn, pointed out that an effective board assessment of corporate systems and controls should consider the review of external auditors. In *China*, the disclosure requirements regarding internal controls also include an external auditor's report on the company's internal control environment. Accordingly, *CSRC China* pointed out the natural role of external auditors as gatekeepers, stating that the audit report should be compared with the company's internal control self-assessments disclosed by the board. This is a relevant tool to pinpoint any gaps in the internal controls system, and to highlight any improvements that have been made. *FSB South Africa* stated that any significant recommendations by external auditors can be adopted in an effort to improve internal audits, and any differences between internal and external audit reports, could be scrutinized by regulators. *CMB Turkey*, *FSA Romania* and *SSF El Salvador* also agreed with external auditor's obligation to immediately (or opportunely) notify the regulator of any fact or act they became aware during the audit, which may contribute to regulatory work in market surveillance[230].

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[226] Chapter V, Principle C, of the OECD Principles.

[227] SVS Chile reported an enforcement concrete case, in which the financial results of a publicly-held company did not fairly reflect the financial situation of the entity. As reported, the SVS found out the quality of the credit portfolio of the entity, and the provisions for losses on this portfolio, were not adequately reflected by the credit policies employed by executives on the company. In trial, the SVS applied sanctions to a total of 22 directors and executives of such company group, and also to the external auditor for infringements related to the publishing of false information to the SVS and to the market regarding the financial situation of the company, which encompassed, among other infringements, breaches in the duty of care and diligence applicable to directors and executives and violations of generally accepted auditing standards.

[228] Item V.B.3 above highlighted the role audit committees may play in this coordination. Other jurisdictions, as SEBI India, also emphasized this role of audit committees when providing their thoughts concerning the role of external auditors.

[229] In other words, external auditors are not just required to certify the fairness of financial statements, but also to include their opinion concerning how financial statements were prepared and presented.

[230] Complementarily, CMA Kuwait requires external auditors to inform the regulator about any essential obstacles, or interference by the board of directors, faced during their work (which comprises the

In terms of oversight, several regulators[231] highlighted the work of external auditors in contributing to the identification of internal controls deficiencies and deviations from corporate governance standards. *The Bank of Russia* and *SEC Pakistan* also cited another useful application of the information produced by external auditors concerning the internal controls, namely that they enable regulators to observe common deviations, creating a critical mass that may lead to recommendations[232] aiming to enhance the effectiveness of the internal structures of companies.

<u>Table V.B.4. Summary of responses regarding external auditors</u>:

External auditors' reports can be a relevant tool for regulators in enhancing internal control environment of companies regarding (i) identified deficiencies and (ii) inconsistencies with internal audit and board self-assessment reports.

C) Key takeaways

Based on the views and practices reported, the CGTF provides the following takeaways to be considered by emerging market regulators:

V.C.1) Disclosure of risk factors should comprise material information, being the companies encouraged to concisely indicate the main risks resulting from the risk identification methodology adopted by the company, and describe how they affect the business;

V.C.2) Sustainability, social and cyber risks are part of board responsibility and should be proportionally emphasized on risk reporting and management;

V.C.3) The adoption of integrated reporting by companies should be encouraged and can be promoted via various means, including recommendations and though interactions between companies and their stakeholders;

V.C.4) Disclosure concerning internal control systems and risk management policies should cover at least the following minimum elements:

(i) a description of the corporate control environment (bodies, committees, reporting lines, channels, functions, responsibilities and coordination), and how it promotes accuracy and high-quality financial and non-financial information;

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review of annual financials, discussions with audit committee, and attendance and participation in general meeting of shareholders).

231 FSB South Africa, CMF Tunisia, SCA United Arab Emirates, FSC Mauritius, Dubai FSA and CNV Argentina.

232 For instance, through corporate governance codes.

(ii) existing control practices and their efficiency, including deficiencies highlighted by the board self-assessment and by the external auditors' report;

(iii) the objectives, strategies and priorities of risk management policies, how they are linked to the assessment, oversight and management of risk factors disclosed;

(iv) the appropriateness of operational structure and effectiveness of risk management policy; and

(v) the key findings of the audit committee.

V.C.5) It should be encouraged a periodical self-assessment report by the board, addressing the efficiency and appropriateness of companies' systems and controls, including identified deficiencies and the appropriate corrective action to be taken;

V.C.6) In order to ensure that disclosed information on the internal control environment is complete and accurate, the analysis of internal controls and systems reported by external auditors should be compared with the company description and the self-assessment made by the board. In addition, regulators can consider establishing a thematic risk-based supervision, when there are recurring identified control failures;

V.C.7) The establishment of specialized subcommittees to support board performance concerning the effectiveness and appropriateness of internal controls and risk policies should be encouraged. As a minimum, this requires establishing an audit committee composed of independent members, and primarily in charge for:

(i) the oversight of internal controls,

(ii) the coordination between the board of directors and internal and external audit, and

(iii) maintaining a permanent and direct communication with the board in this regard.

V.C.8) Regulatory requirements concerning the establishment of a specialized risk committee should consider market conditions and characteristics, segments and scale of companies, so that they do not impose excessive or unnecessary regulatory costs;

V.C.9) Having specialized subcommittees does not release the board from its fiduciary duties and ultimate responsibility for implementation and oversight related to the effectiveness of such systems and policies remain with the board; and

V.C.10) The board is ultimately responsible for ensuring the communication and effective implementation of risk management policies with all levels of staff, embedding compliance in daily business activities, which include informing and training employees, and creating secure and efficient channels for staff to report violations and breaches.

VI. CONCLUSION

The analysis of the practices, perspectives and common concerns of GEM Committee jurisdictions regarding corporate governance is a key step to further develop capital markets.

The survey's results make it clear that GEM capital market regulators are committed to improve standards of corporate governance and to align their regulatory frameworks with international recognized principles[233], while simultaneously recognizing the particular needs and circumstances of their jurisdictions.

There is general agreement on the direction regulators should take regarding improving the quality of boards, ensuring that remuneration and incentive structures work to create long-term value rather than promote excessive risky behavior, as well as improving risk management and internal controls. There are, however, some differences of opinion on how best to achieve this through the right blend of requirements, recommendations and guidance. To some extent, this is the result of unique circumstances in GEM jurisdictions, which may call for specific regulatory approaches.

The survey's results are encouraging. Although they highlight differences in approaches and opinions on the best way forward, they recognize the importance of convergence in corporate governance standards, and they show that steady progress is being made in many jurisdictions.

The scenario reveals **(i)** widely acknowledged international standards, **(ii)** outstanding examples of how regulators should best translate these principles and ideas into proper, transparent and enforceable requirements in their jurisdiction, and, mainly, **(iii)** a common view that capital market regulators, where appropriate and in accordance with their legal mandate, should take on a prominent role in the strengthening of regulatory frameworks applicable to governance structures.

Effective corporate governance is critical to the proper functioning, safety, efficiency and overall stability and resilience of capital markets. Therein, based on acknowledged international standards, global capital markets need consistent and harmonized high quality regulation to identify vulnerabilities that have the potential to trigger a higher level of market risks that could lead to financial instability. To this end, emerging markets regulators, through IOSCO, can play a prominent role in coordinating their activities, benchmark approaches and practices, while taking into consideration the special characteristics and conditions of each market reality[234].

Day to day, capital markets regulators deal with major issues, breaches and instabilities that impact capital markets, which could be prevented through effective corporate governance structures.

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233 G20/OECD Principles on Corporate Governance revised on 2015.

234 It demands a perception, which naturally may vary from jurisdiction to jurisdiction, on the appropriateness of specific eventual regulatory measures in the light of maturity, cultural aspects, traditions and characteristics of their capital markets.

In this sense, the promotion of good governance practices should permeate the regulatory activity in its all dimensions, being translated into proper, balanced and truly effective regulatory requirements, recommendations and policies that contribute to market resilience.

Capital markets regulators should take a relevant role in ensuring the regulatory frameworks consider the best governance practices within their jurisdictions. Accordingly, their views should be an increasingly important reference on the subject in global debates.

The takeaways in each section are not intended at all to represent mandatory prescriptions for GEM regulators, but rather to help regulators **consider possible ways for improvements** in their corporate governance regulatory frameworks.

Corporate governance is a work in progress. As markets continuously evolve, regulatory frameworks must be regularly reviewed and enhanced to meet the needs of companies and investors, keeping pace with best practices, while remembering that good corporate governance constitutes a competitive advantage in a world where different economies are competing for the same sources of funding.

This work in progress requires ongoing interaction among jurisdictions and dialogue with key national stakeholders. Such an approach will allow reconciliation between the desire to set agreed and accepted international, benchmarked standards and best practices, on the one hand, and the need to recognize the specific needs of individual jurisdictions, on the other hand. This will also ensure that the commonalities that underpin the development of a coherent global governance framework are not overwhelmed by the differences that exist in individual jurisdictions and will reduce the risk of regulatory arbitrage and the resulting temptation to "race to the bottom".

This Report should not be regarded as the end of discussions on the best ways forward to ensure effective and relevant improvements in GEM corporate governance.

It should be seen as the starting point of an ongoing process to find ways to continue strengthening emerging capital markets through improved corporate governance standards that are the keystones in the arch of market efficiency, safety and sustainability. The effective implementation of such standards is the foundation upon which social and economic development can be built.

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Collecting these expert opinions, covering different realities and perspectives, has contributed to providing a broad and comprehensive overview of the state of play, as well as complementary (not necessarily convergent) approaches and views with respect to the discussed corporate governance focus areas.

1.1. Appendix A – Listing of Respondents[235]

Aberdeen Asset Management PLC ("Aberdeen")

Associação Brasileira de Companhias Abertas (Brazil) ("Brazil ABRASCA")

Associação de Investidores no Mercado de Capitais (Brazil) ("Brazil AMEC")

Bangladesh Securities and Exchange Commission ("Bangladesh SEC")

BBVA Banco Francés S.A. ("Argentina BBVA")

BM&FBOVESPA S.A. – Bolsa de Valores, Mercadorias e Futuros (Brazil) ("Brazil BM&FBOVESPA")

Bursa Malaysia Securities Clearing Sdn Bhd ("Bursa Malaysia")

Capital Markets Authority of Saudi Arabia ("CMA Saudi Arabia")

Capital Markets Board of Turkey ("CMB Turkey")

Capital Markets Commission of Angola ("CMC Angola")

Central Bank of Hungary (Magyar Nemzeti Bank) ("MNB Hungary")

China Securities Regulatory Commission ("CRSC China")

Comisión Nacional Bancaria y de Valores ("CNBV Mexico")

Comisión Nacional de Valores ("CNV Argentina")

Companies Commission Malaysia ("Malaysian CCM")

Conseil du Marché Financier Tunisien ("CMF Tunisia")

Corporate Governance and Capital Market Centre of the University of Chile

Corporate Governance of the Catholic University of Chile

Croatian Financial Services Supervisory Agency ("HANFA Croatia")

Dubai Financial Services Authority ("Dubai FSA")

Egyptian Financial Supervisory Authority ("Egypt FSA")

235 Listing does not include individual respondents.

Federation of Public Listed Companies Berhad (“FPLC”)

Financial Services Board of South Africa (“FSB South Africa”)

Financial Services Commission (Republic of Mauritius) (“FSC Mauritius”)

Financial Services Commission Chinese Taipei (“FSC Chinese Taipei”)

Financial Services Commission of Jamaica (“FSC Jamaica”)

Financial Supervisory Authority (Romania) (“FSA Romania”)

Financial Supervisory Service of South Korea (“FSS South Korea”)

Instituto Brasileiro de Governança Corporativa (“Brazil IBGC”)

International Corporate Governance Network (“ICGN”)

Israel Securities Authority (“ISA Israel”)

Malaysian Directors Academy (“MINDA”)

Malaysian Institute of Corporate Governance (“MICG”)

Mercado a Término de Buenos Aires (Argentina) (“Argentina MAT”)

Mercado Abierto Electrónico S.A. (Argentina) (“Argentina MAE”)

Minority Shareholder Watchdog Group (“MSWG”)

Non-Bank Financial Institutions Regulatory Authority of Botswana (“NBFIRA Botswana”)

Oman Center for Governance and Sustainability

Russian Association of Institutional Investors (“Russia AII”)

Russian JS Company “R.O.S.T Registrar”

Russian MegaFon PJSC

Russian National Settlement Depository (“Russia NSD”)

Russian PJSC Inter RAO

Russian PJSC Rostelecom

Russian PJSC Severstal

Russian PJSC Norilsk Nickel

Russian VTB Bank JSC

Saudi Aldrees Petroleum & Transport Services Co. (“Saudi Aldrees”)

Saudi Eastern Province Cement Company (“Saudi Eastern Province”)

Saudi Jadwa Investment

Saudi Kayan

Saudi NCB Capital

Saudi SABIC

Saudi Stock Exchange (“Saudi Tadawul”)

Saudi The Savola Group (“Saudi Savola”)

Saudi United Electronics Company

Saudi Yamanah Cement Company

Saudi Yansab

Sberbank of Russia

Schroders Investment Management Limited (“Schroders”)

Securities and Commodities Authority United Arab Emirates (“SCA United Arab Emirates”)

Securities and Exchange Board of India (“SEBI India”)

Securities and Exchange Commission of Pakistan (“SEC Pakistan”)

Securities and Exchange Commission of Thailand (“SEC Thailand”)

Securities Commission of Malaysia (“SC Malaysia”)

State Securities Commission of Vietnam (“SSC Vietnam”)

Superintendencia de Valores de la Republica Dominicana (“SV Dominican Republic”)

Superintendencia de Valores y Seguros (“SVS Chile”)

Superintendencia del Mercado de Valores (Panama) (“Panama SMV”)

Superintendencia del Sistema Financiero (El Salvador) (“SSF El Salvador”)

T. Rowe Price

The Bank of Russia

The Polish Financial Supervision Authority (“KNF Poland”)

Trinidad and Tobago Securities and Exchange Commission (“SEC Trinidad and Tobago”)

UAE Hawkamah (Institute for Corporate Governance)