FSB FINANCIAL STABILITY BOARD

8 August 2016

Thematic peer review on corporate governance

Summary Terms of Reference

1. Introduction

Building more resilient financial institutions is one of the core elements of the FSB's agenda to address the weaknesses that contributed to the financial crisis. This is a multipronged effort, one element of which is work undertaken by the FSB and standard-setting bodies (SSBs) to strengthen risk management practices at firms, including on governance.

Effective corporate governance is critical to the proper functioning of the financial sector and financial stability more generally. In particular, it plays a key role in the resiliency of financial institutions and preventing systemic risks. Recent experience has provided ample evidence of the impact that corporate governance failures can have on financial institutions and markets.

The FSB places great importance on effective corporate governance as evidenced by the fact that the *G20/Organisation for Economic Co-Operation and Development (OECD) Principles of Corporate Governance* (the Principles) have been designated as one of the FSB key standards for sound financial systems. The Principles cover a range of areas, including governance frameworks, disclosure and transparency, and responsibilities of the board, to name just a few.

Implementation of the Principles is assessed as part of the World Bank Reports on the Observance of Standards and Codes (ROSC) initiative.[1] However, corporate governance assessments under the ROSC initiative are at the invitation of country authorities, and only a subset of FSB member jurisdictions (mostly from emerging markets) have been assessed to date.[2] The OECD also assesses implementation but focuses on thematic reviews on certain aspects of the Principles, rather than a broad assessment of the Principles as they apply to financial firms.

In light of the importance and cross-sectoral nature of corporate governance, the FSB's Standing Committee on Standards Implementation (SCSI) agreed to launch a peer review on implementation of the G20/OECD Principles in early 2016. The G20/OECD Principles are foundational to the establishment of effective governance frameworks and a peer review may provide useful insights on these issues. Moreover, as corporate governance is considered as one of the 12 Key Standards for Sound Financial Systems, a review of compliance with the

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[1] The World Bank uses the *OECD Methodology for Assessing the Implementation of the OECD Principles of Corporate Governance* (Assessment Methodology), which will be revised to reflect the recent update to the G20/OECD Principles. See OECD, *Methodology for Assessing the Implementation of the OECD Principles of Corporate Governance*, 2007 (http://www.oecd.org/daf/ca/corporategovernanceprinciples/37776417.pdf).

[2] As of end-2015, the following FSB jurisdictions had been assessed by the World Bank using either the 1999 Principles or the 2004 updated version: Brazil, Hong Kong, India, Indonesia, Korea, Mexico, Saudi Arabia, South Africa and Turkey.

Principles could highlight important vulnerabilities that would be appropriate for further work.

2. Background

The OECD Principles of Corporate Governance were originally developed in 1999, updated in 2004 in the wake of large and disruptive corporate scandals, and again in 2015 drawing upon lessons from the global financial crisis. The most recent update maintains many of the Principles from earlier versions as essential components of an effective corporate governance framework while introducing some new issues and bringing greater emphasis or additional clarity to others. The Principles are designed to apply to publicly traded companies, both financial and non-financial, and cover the following areas or Chapters: (i) ensuring the basis for an effective corporate governance framework; (ii) the rights and equitable treatment of shareholders and key ownership functions; (iii) institutional investors, stock markets and other intermediaries; (iv) the role of stakeholders in corporate governance, (v) disclosure and transparency; (vi) the responsibilities of the board.

These Principles serve as the foundation for a number of sector specific documents on corporate governance, including: the Basel Committee on Banking Supervision (BCBS) *Corporate governance principles for banks*;[3] the OECD *Guidelines for Pension Fund Governance*,[4] and International Association of Insurance Supervisors (IAIS) Principles on Corporate Governance of Insurers.[5]

The OECD is in the process of revising the Assessment Methodology that the World Bank uses as part of its ROSC initiative to assess countries' corporate governance frameworks and company practices in order to evaluate their compliance with the Principles.

3. Objectives

The peer review will take stock of how FSB member jurisdictions have applied the Principles to publicly listed financial institutions. It will also provide an opportunity to 'road-test' the revised Assessment Methodology for the Principles so that any relevant findings can be incorporated before the methodology is finalised. The peer review will therefore have the following objectives:

- Take stock of implementation of the Principles as they pertain to listed financial institutions by FSB member jurisdictions, identifying effective practices and areas where good progress has been made while noting gaps and areas of weakness;
- Inform the update that is currently underway of the OECD's Assessment Methodology, which is used as the basis for the detailed country assessments undertaken by the World Bank Corporate Governance ROSC initiative;
- Provide input to the governance-related aspects of the FSB's broader work on conduct

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3 See BCBS, *Corporate governance principles for banks*, 2015, at http://www.bis.org/bcbs/publ/d328.pdf.

4 See OECD, *OECD Guidelines on Insurer Governance*, 2011 at http://www.oecd.org/finance/insurance/48071279.pdf and *OECD Guidelines for Pension Fund Governance*, 2009 at http://www.oecd.org/daf/fin/private-pensions/34799965.pdf.

5 See, for example, Insurance Core Principles 4, 5, 7 and 8 at http://iaisweb.org/index.cfm?event=getPage&nodeId=25227.

for financial institutions; and

- Identify possible areas of follow-up or where further work could be undertaken to further promote effective governance within financial institutions.

The aforementioned objectives are consistent with the objectives set out in the *Handbook for FSB Peer Reviews* (*Handbook*).

4. Scope

SCSI members agreed that the peer review will focus only on those Principles that are most pertinent for listed regulated financial institutions (e.g. banks, insurers, asset managers and financial holding companies) in FSB member jurisdictions. Although the review would only be able to provide input into the Assessment Methodology as it applies to financial institutions for those Principles reviewed, it may allow for a more in-depth analysis of particular topics relevant for broader FSB work. In collaboration with the OECD Corporate Governance Committee, the review will also explore particular areas of the Assessment Methodology where more guidance is sought.

The overarching criterion used to determine specifically which Principles are included within the scope of the peer review is their relevance to the FSB's work. When making this determination, the peer review will be mindful of similar work being undertaken by other groups, both within and outside the FSB, and will seek to avoid any possible overlaps or duplication resulting therefrom.

More concretely, the following five criteria – with somewhat greater weight given to the first two – will be used to ascertain whether a Principle falls within the scope of the peer review:

1. Principles that are relevant to FSB work, such as where the findings of the peer review in relation to a Principle may serve as a useful input to other areas of FSB work.
2. Principles that relate to the most significant aspects of corporate governance which are likely to impact financial stability.
3. New or revised Principles in the 2015 update to the G20/OECD Principles that would benefit from being "road-tested".
4. Principles that can be readily evaluated through a questionnaire to which authorities will be able to provide meaningful and practical responses.
5. Principles that are sufficiently specific (i.e. not excessively "high-level") and fall within the expertise of the peer review team.

The peer review will give priority to the Principles included in Chapters I, V and VI (Ensuring the basis for an effective corporate governance framework; Disclosures and transparency; The responsibilities of the board).

In carrying out this work, the peer review will seek to identify: lessons of experience and good practices in the implementation of the Principles; common challenges faced by jurisdictions in implementing the Principles and plans or actions taken to overcome them; and material weaknesses, inconsistencies and gaps in implementation that are common across jurisdictions and that, where necessary, could be the focus of peer review recommendations.

The review will not cover implementation of the corporate governance principles or any other standards issued by the BCBS, IAIS, or the International Organization of Securities Commissioners (IOSCO) in relation to corporate governance. National authorities may however, wish to provide information describing how implementation of the OECD Principles are enhanced through their implementation of sector-specific guidance.

5. Process

The primary source of information for the peer review will be responses to a questionnaire that will be prepared by the peer review team and agreed by SCSI. All FSB member jurisdictions will be expected to provide a consolidated national response to the questionnaire, covering all relevant sectors in their jurisdiction. The review team will then analyse the responses and may follow up with individual jurisdictions to seek clarifications or obtain additional information as needed. As with past peer reviews, a request for public feedback will be posted on the FSB website, asking for comments and suggestions on the topics covered by the peer review. The review team will also dialogue with financial institutions, as appropriate, during the drafting of the questionnaire and review of the responses to better understand *inter alia* challenges they may face with implementation of the Principles.

In undertaking its work, the review team will interact closely with the OECD Corporate Governance Committee and, as appropriate, with the standard-setting bodies (SSBs). The peer review team (through the FSB and OECD Secretariats) will keep the OECD updated on progress with the review and share any interim findings for feedback to help ensure that the recommendations are broadly understood and can be appropriately considered in its work plan. The FSB Secretariat will also liaise with the SSBs as necessary to update them on progress and to exchange views on issues that may be relevant for their respective work.

6. Peer review report

The peer review report will summarise information provided by FSB member jurisdictions concerning their practices and experiences with respect to implementation of the Principles, and will provide examples of good practices and lessons learned. It will also identify issues where FSB recommendations may be useful to address identified gaps and weaknesses.

As stated in the *Handbook*, the report "will give particular attention to weaknesses common across a number of jurisdictions, problems caused by a lack of cross-country consistency in implementation… and lessons from implementation experience." The findings may be used to provide recommendations for improvements and follow-up actions in areas where challenges and obstacles to the implementation of the Principles remain.

The draft report will be submitted to the SCSI, and subsequently to the Plenary, for review and approval. The approved report will be published on the FSB's website.