

Conclusions by the OECD Corporate Governance Committee

A sustainable recovery of the corporate sector is a key policy priority following the COVID-19 crisis. The corporate sector has played a central role in tackling the health crisis through research and innovation, and by providing a steady supply of goods and services during a time of disrupted global value chains. At the same time, the pandemic has also forced the corporate sector to adapt, and possibly induced long-term structural changes.

Some business models will be phased out or change in character, while others will be premised on new opportunities for innovation and growth. While the crisis might induce such a process of dynamic transformation, there are also concerns that parts of the corporate sector that were under-capitalised before the crisis will exit it with even higher debt levels and that an increased amount of productive resources will be tied up in non-viable companies, dragging down overall investment and economic growth.

The exact trajectory of these structural changes is, at this juncture, difficult to predict. What is certain however, is that the road to recovery will require well-functioning capital markets that can allocate substantial financial resources for long-term investments and a corporate governance framework that gives investors, executives, corporate directors and stakeholders the tools and incentives needed to make sure that corporate practices are adapted to the post-COVID-19 reality.

Drawing on a wealth of national experiences from adapting corporate governance frameworks to the evolving crisis conditions and informed by the report “*The Future of Corporate Governance in Capital Markets Following the COVID-19 Crisis*” that provides an evidence-based overview of developments globally, the OECD Corporate Governance Committee highlights the following messages:

Making public equity markets support recovery and long-term resilience

Stock markets play a key role in providing companies with equity capital that gives them the financial resilience to overcome temporary downturns, while meeting their obligations to employees, creditors and suppliers. At the same time, since 2005 more than 30 000 companies have delisted from stock markets globally, notably in the United States and Europe. These delistings have not been matched by new listings, which has resulted in a considerable net loss of publicly listed companies.

This means that compared to the 2008 financial crisis, many thousand fewer companies have so far been able to access this important source of market-based finance. In particular, the structural decline

of smaller company IPOs means that a larger portion of smaller growth companies have been distanced from immediate access to public equity financing.

- It should be an overarching policy objective to facilitate access to public equity markets for sound businesses. This will help strengthen the balance sheets of viable corporations and the emergence of new business models that are essential for a sustainable recovery and long-term resilience in the case of future shocks.
- From the perspective of inclusiveness, a well-functioning public equity market should also provide ordinary households with the opportunity to directly or indirectly share in the return on capital, giving them additional options for managing savings and planning for retirement.
- In times of crisis, there are typically calls for more demanding corporate governance, compliance and disclosure standards in the non-financial sector. The current crisis is no exception. When evaluating an adaptation to the post-COVID-19 landscape, policy makers and regulators should carefully assess the long-term costs and benefits of interventions, and avoid over-regulation that may discourage companies from going or staying public.
- Steps should be taken to address any structural weaknesses in the stock market ecosystem that discourage smaller growth companies from going public. Policy makers and regulators should take a proactive approach to address the cost of listings and ensure that there are no unnecessary barriers or regulatory and supervisory uncertainties for companies that want to use new alternative listing practices, such as direct listings and online book building.
- To balance the current focus on large listed companies by institutional investors, steps should be taken to improve the visibility and attractiveness of smaller growth companies, for example through dedicated analyst coverage programmes and specialised incubator programmes to prepare growth companies for capital market financing.

Adapting the corporate governance framework

A strong corporate governance framework is essential for a well-functioning capital market. It reassures shareholders that their rights are protected and makes it possible for corporations to lower their cost of capital. This is why the *G20/OECD Principles of Corporate Governance* were developed with an understanding that corporate governance policies have an important role to play in achieving broader economic objectives with respect to investor confidence, capital formation and allocation. To tackle the challenges imposed by the COVID-19 crisis, this perspective is more important than ever.

- The pandemic has raised concerns and triggered lawsuits with respect to the quality of risk-related disclosures. Although most COVID-19-related lawsuits are yet to be adjudicated, experiences from the pandemic call for improvements in the frameworks for risk and crisis management (including health, supply chain, reputational and environmental risks) as well as related issues such as audit quality, stock price manipulation and insider trading. In certain areas, the monitoring and disclosure of risks may be enhanced by the use of new digital technology.
- An important development in several markets is the increase in company group structures. The more complex the structure of a group, the more complex the governance arrangements and the greater the scope for potential abusive practices. Special attention should therefore be given to address inadequacies in national disclosure frameworks related to capital and control structures in company groups, including shareholdings of directors, the approval of related party transactions, the flow of information and the scope of parent company board responsibilities throughout the group.
- During the past decade, several markets have seen an increase in ownership concentration, which to a large extent is attributable to growing state ownership through various state-controlled

investors. Against this background, policy makers and regulators should ensure a level playing field with respect to the governance of state-controlled listed companies and their private investor-owned peers. All categories of shareholders in state-controlled listed companies should be treated equitably and the company should adhere to the same transparency and disclosure standards as other listed companies.

- With respect to shareholder meetings, countries should benefit from experiences during the COVID-19 crisis in order to advance or clarify their regulatory frameworks for remote participation. This should improve the possibilities for all shareholders to follow the meeting and as appropriate pose questions to corporate officers. Regulators will need to decide on the temporality of current measures adopted during the crisis.
- After the COVID-19 outbreak, there have been concerns that some companies may have re-arranged the terms for executive remuneration by adapting performance metrics and ignoring missed targets. To ensure the link between executive remuneration and long-term corporate performance, experiences from such practices call for renewed scrutiny of the conditions and procedures for deciding and overseeing performance-related pay.

Improving the management of environmental, social and governance risks

The COVID-19 pandemic has brought increased attention to the importance of identifying systemic risks and unexpected shocks. Importantly, it has led many investors to consider environmental, social and governance (ESG) risks when making their investment and voting decisions. It is policy makers' and regulators' responsibility to ensure that investors have access to consistent, comparable, and reliable material information when managing their savings and assets.

Clearer ESG disclosure frameworks will also help the corporate sector meet increased expectations when it comes to recognising and appropriately balancing the interests of different stakeholders, including investors, employees, creditors, customers and suppliers, and their contribution to the long-term success of corporations.

- As the pandemic highlights new experiences with respect to ESG risk factors, companies should ensure that they have the expertise, information channels, analytical tools, and internal policies and practices that are specifically tailored to assessing their ESG risk factors.
- In response to an increasing demand that material information related to ESG risks should be disclosed to guide investor decisions and improve capital allocation, policy makers and regulators should facilitate the development of comprehensive ESG frameworks, notably with the purpose of producing consistent, comparable, and reliable climate-related disclosure.
- Corporate boards should demonstrate a leadership role to ensure that effective means of environmental, social and governance risk oversight are in place, establishing clear lines of responsibility and accountability for the quality and integrity of the monitoring and disclosure system throughout the company and its subsidiaries.

Addressing excessive risk taking in the non-financial corporate sector

At the onset of the COVID-19 crisis, there were already widespread concerns about the declining quality of the constantly growing stock of outstanding corporate bonds. Over the last decade (with the exception of 2018) more than 20% of the total annual amount of all bond issues by non-financial companies were non-investment grade. Importantly, over the past three years, the portion of BBB rated bonds - the lowest investment grade rating - has reached of 52% of all investment grade issuance, up from 39% during the 2000-2007 period.

- The surge in the use of bond financing has highlighted the role of corporate bonds in corporate governance and the conditions that bondholders may stipulate with respect to, for example,

dividend payments, capital structure and disclosure. Particularly in markets where the use of corporate bonds has only recently become a significant source of corporate financing, the regulatory framework should require companies to disclose if they are at material risk of not meeting their covenants.

- In an era when recapitalisation of many companies has become vital, companies should also disclose if their current financing arrangements include terms that would limit their ability to obtain additional funding, as well as how these terms could influence the outcomes of workouts and even lead to liquidity problems that would make the company unable to maintain current operations.
- The increase in borrowing by high-risk non-investment grade companies to finance share buyback operations has raised major concerns about excessive risk taking in the corporate sector, since it increases the leverage ratio by simultaneously reducing the company's equity base and increasing its debt. The management and board are best placed to decide on the optimal capital structure, subject to the approval of the shareholders. In doing so, however, they should ensure that proper risk assessment procedures are in place considering different scenarios, the best long-term interest of the company and its financial soundness.

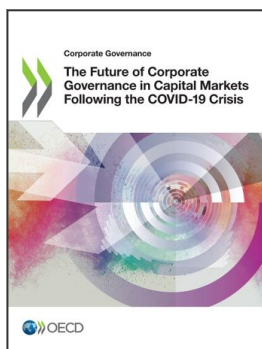
An insolvency framework for recovery and resilience

Bondholders and creditors are key corporate stakeholders with specific claims and governance rights. The terms, amount and type of credit that a company can access will depend on the enforceability of these rights. In a time of crisis when extraordinary measures with respect to insolvency proceedings and liquidity support are in place, corporate boards should be expected to continue taking due regard of and deal fairly with all creditors.

Given the severe economic consequences of the pandemic and the increase in insolvencies in industries such as air transport, hospitality, real estate and related sectors, it is crucial to ensure sound governance of insolvency and restructuring processes that allow for efficient and swift exits of non-viable companies and successful restructurings of viable ones.

- Drawing from experiences of tackling liquidity and solvency challenges during the pandemic, policy makers and regulators should take the opportunity to review the overall efficiency of their insolvency frameworks and the extent to which market-driven workouts can serve as an effective practice to preserve, restructure and re-allocate capital.
- Considering that the portion of under-capitalised, non-viable firms will increase in the wake of the pandemic, temporary measures introduced should be re-visited to ensure that resources are not perpetually tied up in underperforming companies.

Based on these conclusions and experiences from longer-term developments in the corporate and capital market landscape, the OECD Corporate Governance Committee has agreed to undertake a review of the *G20/OECD Principles of Corporate Governance* with a view to adapt their key elements to the post-COVID-19 environment.



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