

Corporate Governance and Growth: Effective Implementation of Principles in Japan

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This presentation represents the presenter's own views, not necessarily identical to those of the Financial Services Agency of Japan or OECD.

Overview

1. Update of Corporate Governance Reform in Japan

- ◆ Implementation status of corporate governance
- ◆ CG code and growth companies
- ◆ New challenges
- ◆ CG reform and economic result

2. Financing Growth Companies

- ◆ Investment to venture business
- ◆ SME financing and lending
- ◆ IPO trend

1. Update of Corporate Governance Reform in Japan

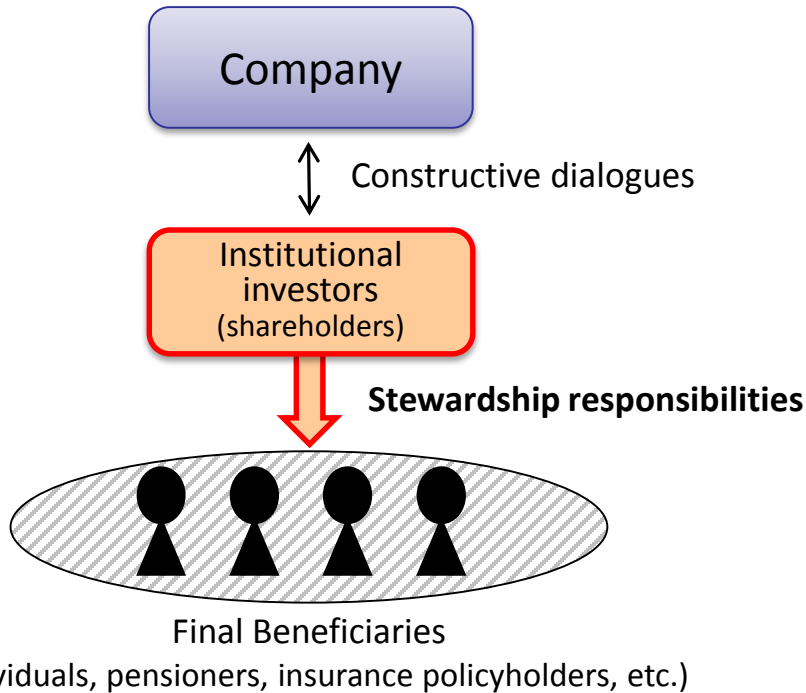
- ◆ Implementation status of corporate governance

Outline of the Stewardship Code & Corporate Governance Code

Stewardship Code

Established in February 2014

- ◆ Principles of good practices for institutional investors
- ◆ Responsibilities of final beneficiaries (entrusters of assets)

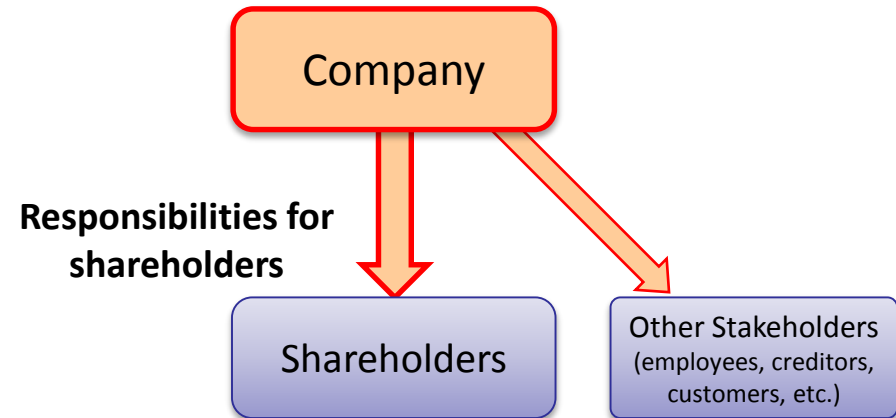


Japan's Stewardship Code was finalized in February 2014 under the Japan Revitalization Strategy (Cabinet decision in June 2013).

Corporate Governance Code

Entered into force in June 2015

- ◆ Principles of good practices for companies
- ◆ Responsibilities for shareholders and other stakeholders



Japan's Corporate Governance Code [Final Proposal] was finalized in March 2015 under the Japan Revitalization Strategy [Revised in 2014] (Cabinet decision in June 2014).

Two Wheels
of a Cart

Participants of The Stewardship Code

■ Almost all major institutional investors in Japan have already accepted the Stewardship Code. In total, 213 domestic and foreign investors have expressed compliance with it.

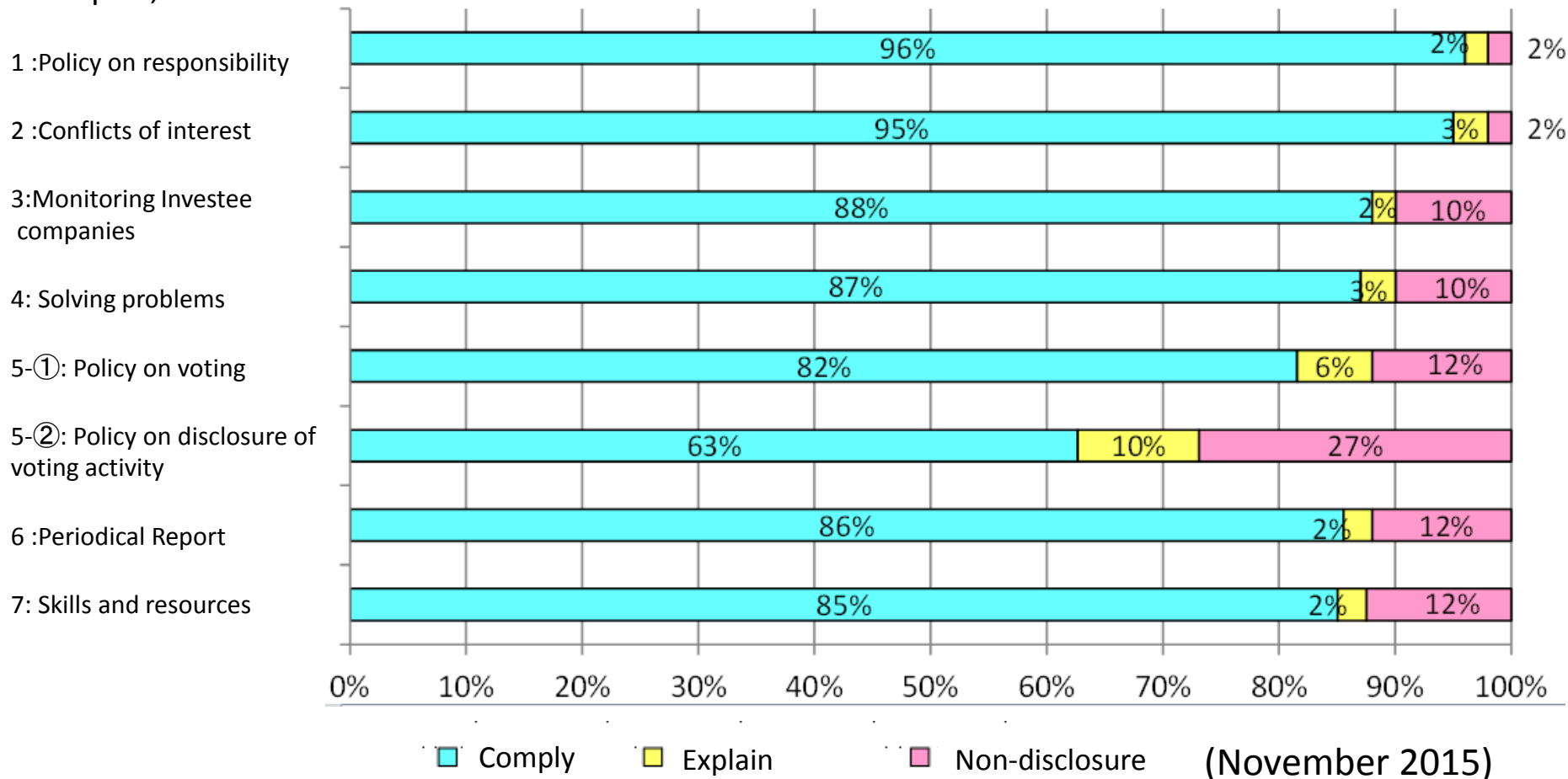
• Trust banks :	7
• Investment managers :	151
• Pension funds :	26
• Insurance companies :	22
• Others (service providers, etc.) :	7
Total :	213

(2 September 2016)

Implementation of Stewardship Code

■ 201 investors comply with around 90% of Stewardship Code's Principles.

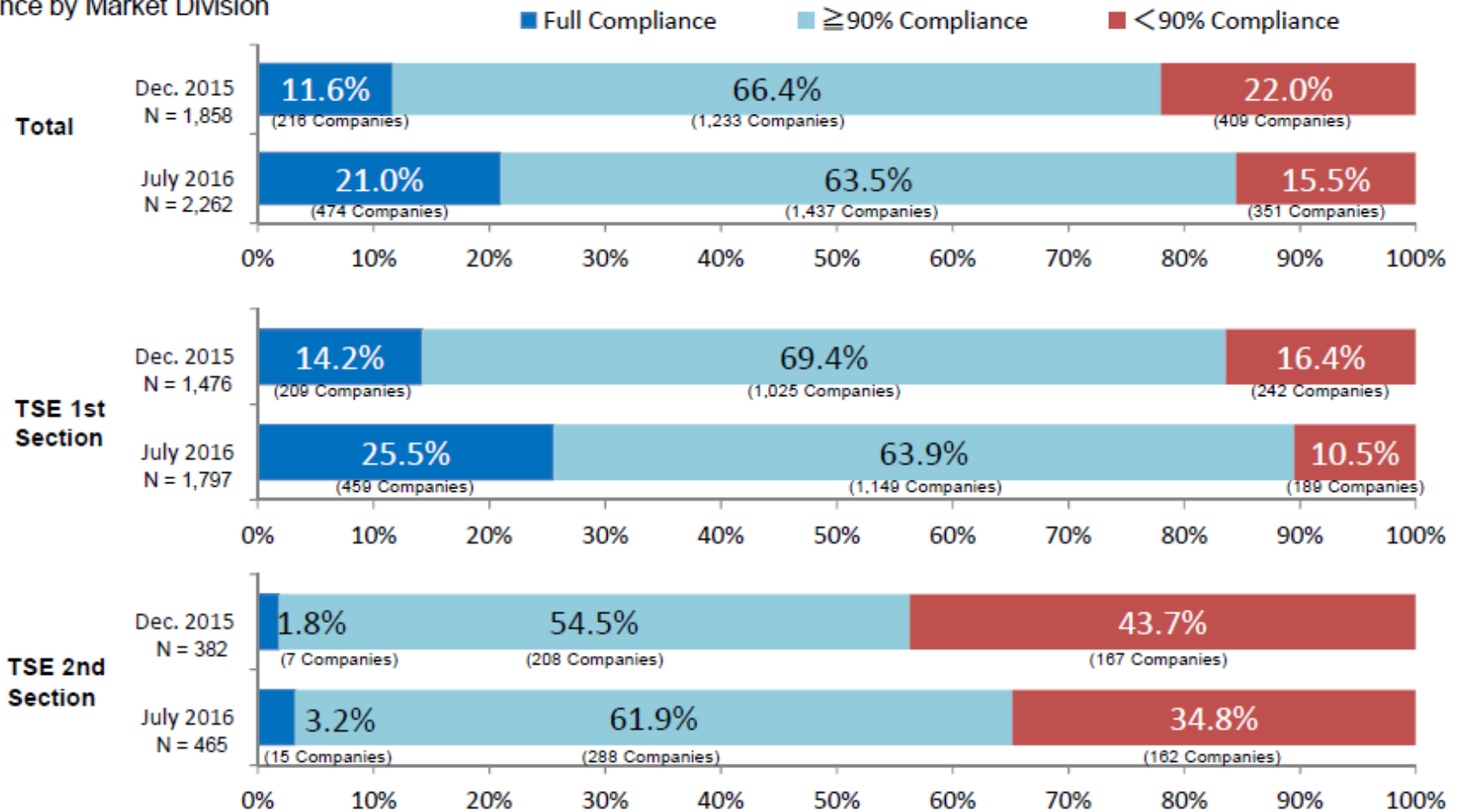
Principles;



Implementation of Corporate Governance Code①

- As of July 2016, 2,262 companies listed on the TSE 1st & 2nd Sections have disclosed their responses to the Code (+404 companies from Dec. 2015)

Compliance by Market Division



Implementation of Corporate Governance Code②

- Among the principles which marked relatively high “explain” ratio, “Board evaluation and disclosure of summary” and “Two or more independent directors” have significantly improved.

Principles	Content	No. of Companies Complying	No. of Companies Explaining	Explanation Rate	Change from Dec. 2015
SP 1-2-4	Electronic voting / English AGM notices	1,001	1,261	55.7%	-0.1pt
SP 4-11-3	Board evaluation and disclosure of summary	1,245	1,017	45.0%	-18.7p
SP 4-2-1	Remuneration reflecting mid-to-long term growth	1,587	675	29.8%	-0.8pt
SP 3-1-2	Provision of English language disclosures	1,626	636	28.1%	2.3pt
SP 4-10-1	Involvement and advice from independent directors on remuneration / nomination	1,694	568	25.1%	-4.3pt
P 4-8	Two or more independent directors	1,783	479	21.2%	-21.3p

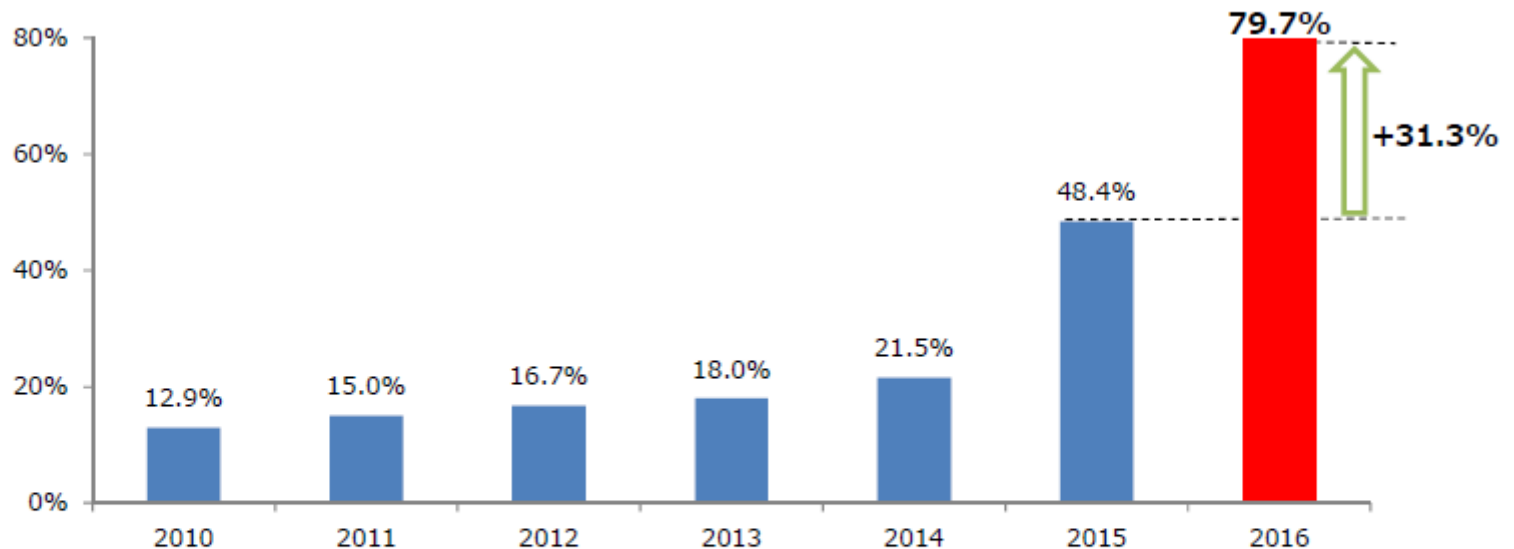
Principle whose explanation rate dropped below 20%

Principle	Content	No. of Companies Complying	No. of Companies Explaining	Explanation Rate	Change from Dec. 2015
P 3-1	Disclosure on corporate governance i) Company objectives, business strategies, and business plans; ii) Basic views and guidelines on corporate governance based on each of the principles of the Code; iii) Board policies and procedures in determining the remuneration of senior management and directors; iv) Board policies and procedures in the appointment of senior management and nomination of directors and <i>kansayaku</i> candidates; and v) Explanations with respect to individual appointments and nominations based on iv).	1,943	319	14.1%	-14.0pt

Appointment of two or more Independent Directors

- 79.7% of the 1st Section Companies appoint two or more independent directors..

[Ratio of 1st Section Companies with two or more Independent Directors]



* Figures for years prior to 2016 are based on corporate governance reports. The figures for 2016 are based on corporate governance reports submitted by listed companies as of July 14, 2016.

What is an "Independent Director"?

An outside director that is designated as an independent director under the TSE listing rules. To protect the interests of general shareholders, TSE requires listed companies to file highly independent outside directors/auditors as independent directors/auditors.

Reduction of strategic shareholdings

	Book value of domestic listed stocks (March 2003)	Book value of domestic listed stocks (March 2015)	Disposal Plan (proportion)	Targeted period
MUFG	6.1(JPY tn)	2.8(JPY tn)	▲0.80(JPY tn) (approx. ▲30%)	Over the next 5 years
Mizuho	3.9(JPY tn)	2.0(JPY tn)	▲0.55(JPY tn) (approx. ▲30%)	Over the next 3.5 years
SMFG	3.2(JPY tn)	1.8(JPY tn)	▲0.50(JPY tn) (approx. ▲30%)	Over the next 5 years

1. Update of Corporate Governance Reform in Japan

- ◆ CG code and growth companies

How Listed Companies Have Addressed the CG Code

■ Not only in TSE 1st and 2nd sections, but also in Mothers and JASDAQ (markets for growth companies), companies adopting the CG code are increasing. (almost doubled in Mothers from Dec. 2015 to July 2016)

- Japan's CG Code came into effect on June 1, 2015.
- As of July 14, 2016, 3,164 companies submitted CG reports with a statement of "Comply or Explain" as per the Code.

Market Division	No. of companies	Change from Dec 2015	Scope of "Comply or Explain"
TSE 1st Section	1,797	+321	All 73 Principles { 5 General Principles ("GP") 30 Principles ("P") 38 Supplementary Principles ("SP")
TSE 2nd Section	465	+83	
Mothers	197	+92	Only 5 General Principles
JASDAQ	705	+183	
TOTAL	3,164	+679	

- We analyzed 2,262 companies listed on the TSE 1st & 2nd Sections as follows.

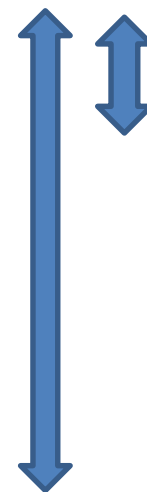
CG code application to companies listed in Mothers and JASDAQ

- The obligation to explain is relaxed for companies listed on Mothers or JASDAQ.
- ※ For Mothers or JASDAQ companies, the requirement of “explain” in the report is limited to the non-compliance with the "General Principles" of the Code.

	5 Chapters				
three-layer structure	Securing the Rights and Equal Treatment of Shareholders	Appropriate Cooperation with Stakeholders Other Than Shareholders	Ensuring Appropriate Information Disclosure and Transparency	Responsibilities of the Board	Dialogue with Shareholders
General Principles	codes that shows the universal ideas and goals should be realized by the development of Corporate Governance				
	1	1	1	1	1
Principles	codes that shows the more specific measures to realize the universal ideas and goals				
	7	5	2	14	2
Supplementary Principles	codes that supplement the Principles				
	9	3	4	19	3

1st Section
2nd Section

JASDAQ,
Mothers



Appointment of Independent/outside Directors

- Not only in TSE 1st and 2nd sections, but also in Mothers or JASDAQ the number of companies appointing independent/outside directors are increasing.

	Number of Companies	Companies with two or more Independent Directors		Companies with Independent Directors		Companies with Outside Directors	
		Number	Ratio	Number	Ratio	Number	Ratio
1 st Section	1,966	1,566	79.7%	1,909	97.1%	1,943	98.8%
		(+653)	(+31.3%)	(+268)	(+10.1%)	(+164)	(+4.5%)
2 nd Section	536	300	56.0%	489	91.2%	526	98.1%
		(+192)	(+36.4%)	(+123)	(+24.8%)	(+50)	(+11.7%)
Mothers	234	70	29.9%	187	79.9%	218	93.2%
		(+43)	(+17.2%)	(+61)	(+20.5%)	(+47)	(+12.5%)
JASDAQ	771	183	23.7%	533	69.1%	671	87.0%
		(+98)	(+13.4%)	(+116)	(+18.5%)	(+63)	(+13.2%)
Total	3,507	2,119	60.4%	3,118	88.9%	3,358	95.8%
		(+986)	(+27.8%)	(+568)	(+15.5%)	(+324)	(+8.4%)
JPX-Nikkei Index 400	400	361	90.3%	394	98.5%	397	99.3%
		(+71)	(+17.6%)	(+21)	(+5.0%)	(+9)	(+2.1%)

* Change from previous year indicated in parentheses.

1. Update of Corporate Governance Reform in Japan

- ◆ New challenges

G20/OECD Principles of Corporate Governance on Stock market

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

- What traditionally were called “stock exchanges” today come in a variety of shapes and forms. Most of the large stock exchanges are now profit maximising and themselves publicly traded joint stock companies that operate in competition with other profit maximising stock exchanges and trading venues. Regardless of the particular structure of the stock market, policy makers and regulators should assess the proper role of stock exchanges and trading venues in terms of standard setting, supervision and enforcement of corporate governance rules. This requires an analysis of how the particular business models of stock exchanges affect the incentives and ability to carry out these functions.

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

- Effective corporate governance means that shareholders should be able to monitor and assess their corporate investments by comparing market related information with the company’s information about its prospects and performance. When shareholders believe it is advantageous, they can either use their voice to influence corporate behaviour, sell their shares (or buy additional shares), or re-evaluate a company’s shares in their portfolios. The quality of and access to market information including fair and efficient price discovery regarding their investments is therefore important for shareholders to exercise their rights.

Japan's approach toward recent changes of financial markets

- Since the late 1990s, significant efforts toward diversifying trading platforms and financial products, enhancing trading systems/technologies, and unifying exchanges in Japanese markets have been made so as to improve the function of our financial markets and enhance its competitiveness.
- Now, new policy measures should be considered in order to deal with the current challenges faced by our financial markets and exchanges:
 - A significant increase in high-speed algorithmic trading, whose effects on the financial markets are widely discussed in many jurisdictions,
 - Under the recent financial conditions, portfolio diversification and sophistication of asset management activities are becoming even more important than ever, and
 - The development of FinTech such as block-chain technology is now a rapidly emerging and it internationally becoming an important topic for the securities' markets.



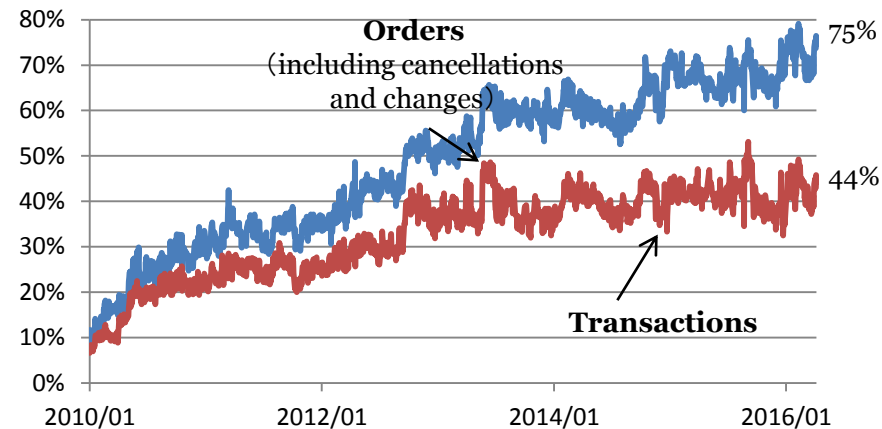
Taking account of the current market development, including IT innovation, JFSA believes that various issues in our financial markets and exchanges need to be addressed from a broader perspective.

Remaining Challenges ① : High-Speed Trading

Background

- ◆ In January 2010, Tokyo Stock Exchange (TSE) launched its new trading system, where one order can be executed within 1 millisecond. In September 2015, TSE upgraded its system up to global-standard.
- ◆ Since TSE launched its co-location service in January 2010, the share of algorithmic orders has been increasing accounting for nearly 70% of total orders in January 2016.

Shares of orders and transactions from TSE's co-location site
(mainly used by trades with high-speed, algorithmic techniques)



Under MiFID II, high-frequency algorithmic traders must be authorized as an investment firm and take the measures, including but not limited to: effective systems and risk control; and obligation to notify and provide information to the competent authority.

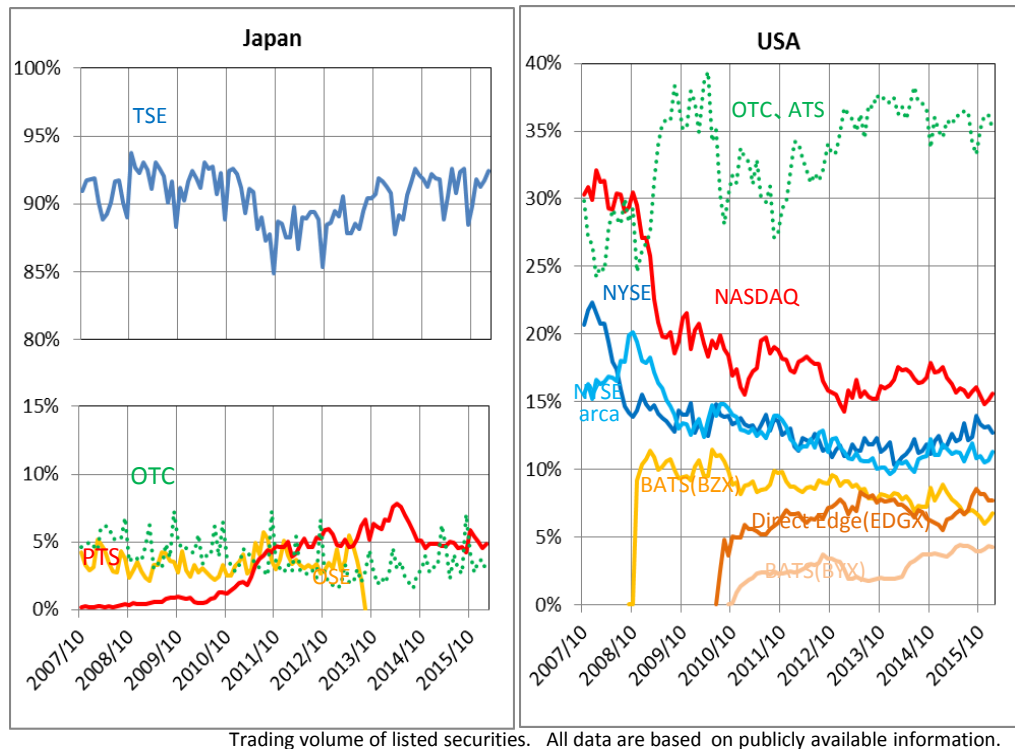
Possible Risks and challenges posed by high-speed algorithmic trading :

- **Stability and resiliency of markets**
- **Efficiency of markets**
- **System risks posed by HFT**
- **Integrity of markets**
- **Fairness of markets**
- **Price discovery functions of markets**

Remaining Challenges ② Alternative Trading Platforms

Background

- ◆ The establishment of Japan's alternative trading platforms, known as proprietary trading system (PTS), was established in 1998 and had contributed to the development of trading system in Japan. The market share of PTSs, however, has stalled at about 5 percent.
- ◆ While a series of US securities regulations have promoted competition among trading venues, it might also foster a fragmented market where more than 50 trading venues are competing with each other. The Nasdaq's share of trading in its listed stocks has dropped to nearly 15%, while the combined share of those alternative trading venues has increased up to nearly 35%.



Agenda

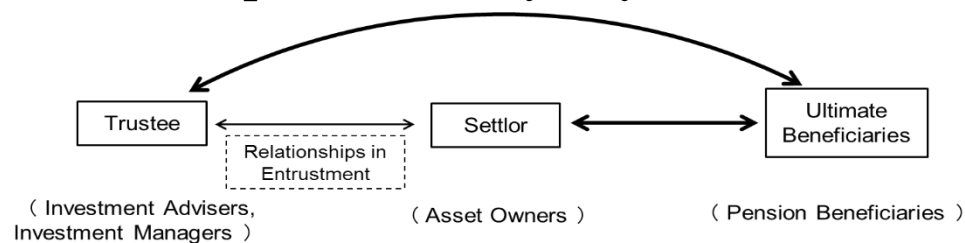
- **Competitions among trading venues and PTS**
- **Market fragmentation**
- **Level playing field between exchanges and PTS**
- **Self-regulatory framework and dark-pool**

Remaining Challenges ③ : “Fiduciary Duty”

Agenda

JFSA’s Strategic Directions and Priorities state that the JFSA will review whether financial intermediaries that produce/distribute/manage financial products such as investment trusts and savings-based insurance products put customers’ interests first. The JFSA will also support self-efforts by the industries for enhancing their practices that meet fiduciary standards. It needs to consider what measures should be taken to ensure that these principles are well-practiced in the financial markets.

The concept of a fiduciary duty in ERISA



OECD: G20 High-Level Principles on Financial Consumer Protection(2011), Update Report on the Work to Support the Implementation of the Principles(2013)

- ◆ Financial services providers, brokers and advisors, etc. have to work in the best interest of their customers.
- ◆ The effective approaches provided therein are of interest across all financial services sectors – including banking and credit, investment, securities, insurance and pensions.

G20/OECD: Principles of Corporate Governance(2015)

- ◆ The corporate governance framework should provide sound incentives throughout the investment chain.
(Note: The investment chain is often long and complex, with numerous intermediaries that stand between the ultimate beneficiary and the company.)

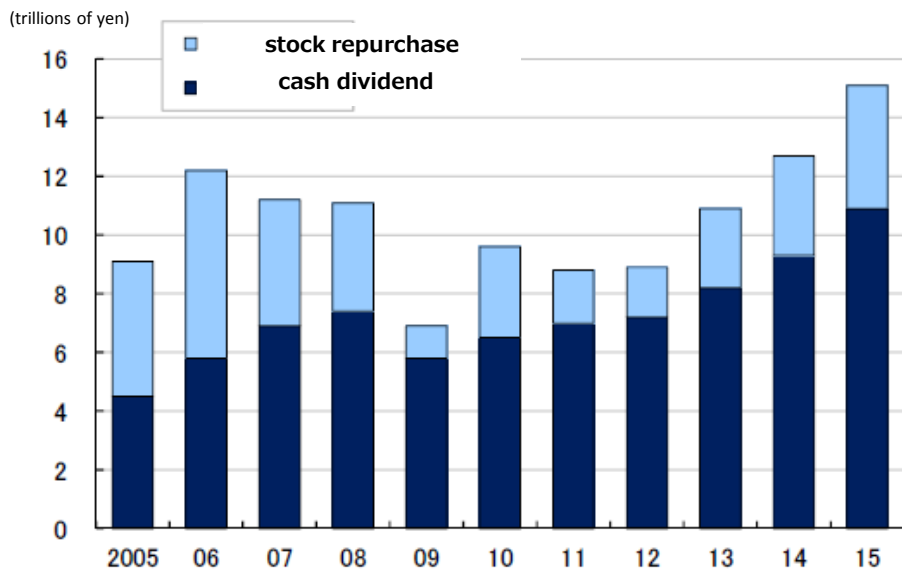
1. Update of Corporate Governance Reform in Japan

- ◆ CG reform and economic result

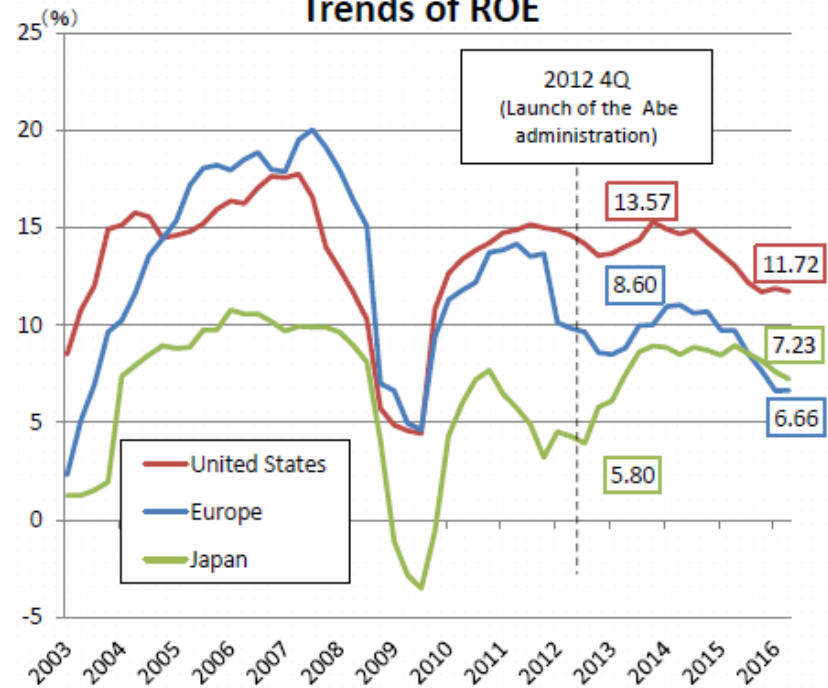
Economic Result ① : Trend of ROE

- The amount of cash dividend and stock repurchase has increased.
- ROE improved by 2.4 p.p. since launch of the Abe administration. (2012 4Q : 5.8% → 2016 1Q : 8.2%)

The amount of cash dividend and stock repurchase

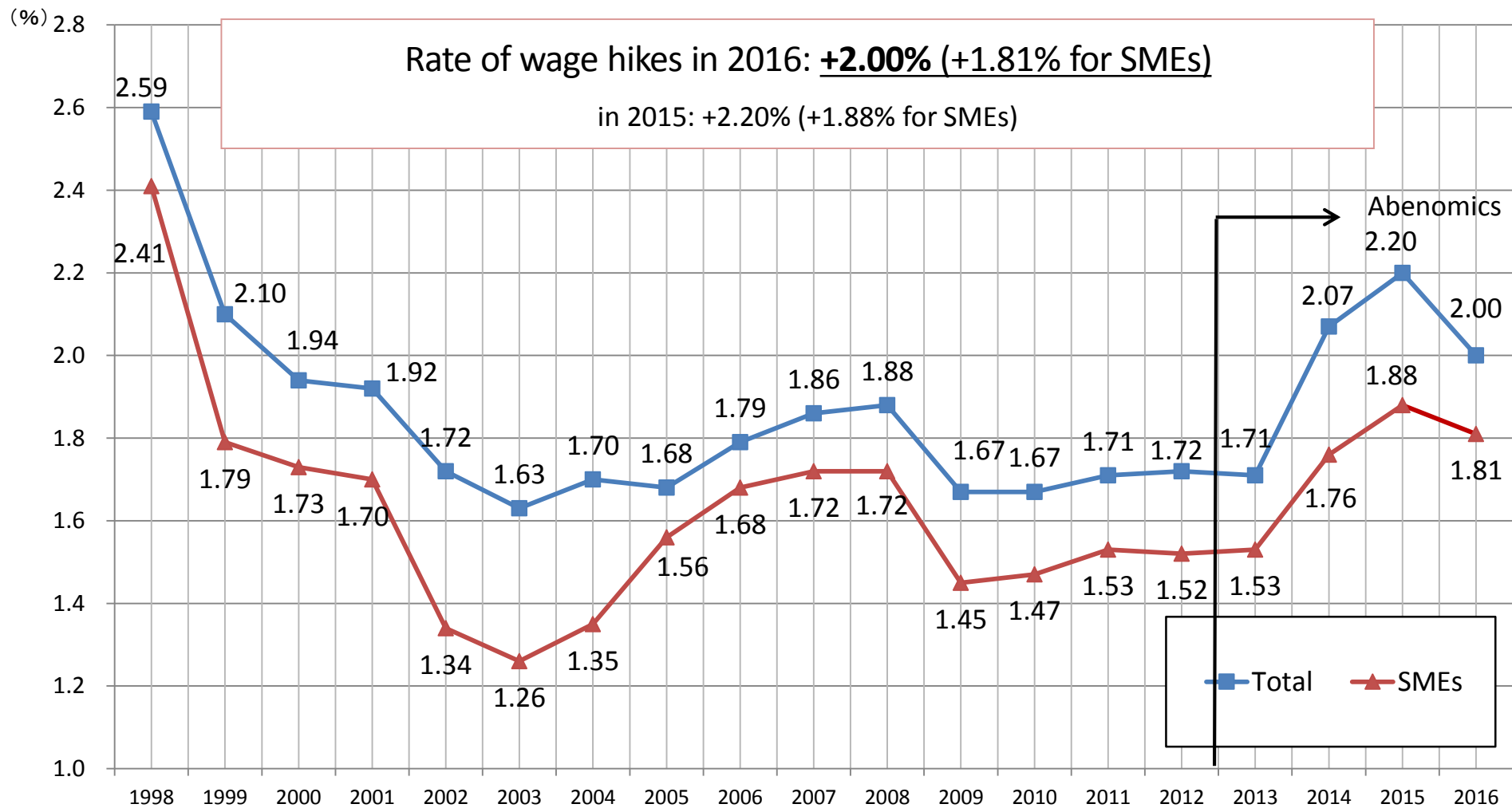


Trends of ROE



Economic Result ② : Rate of Wage Hikes

■ Tight labour market condition is reflected in an increase in wages. Under Abenomics, the government encourages corporate sector to secure wage hike.

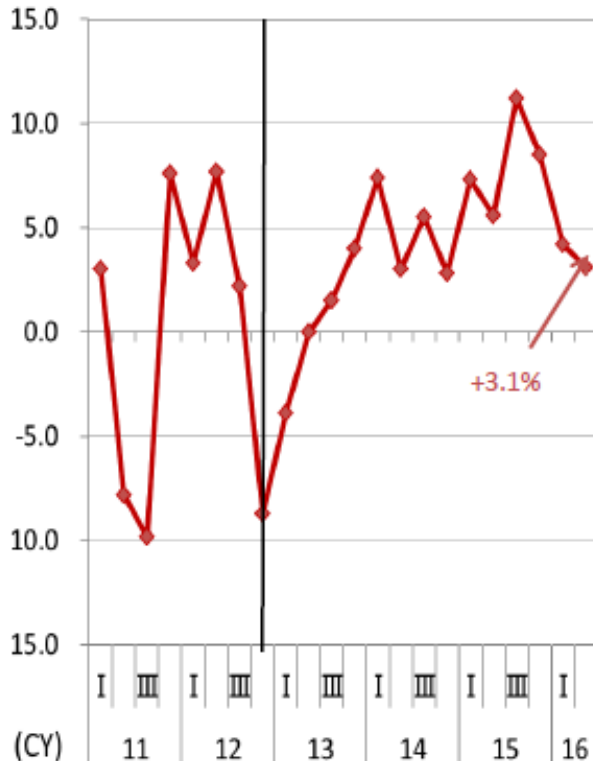


Economic Result ③: Corporate Earnings, Savings & Capital Investment

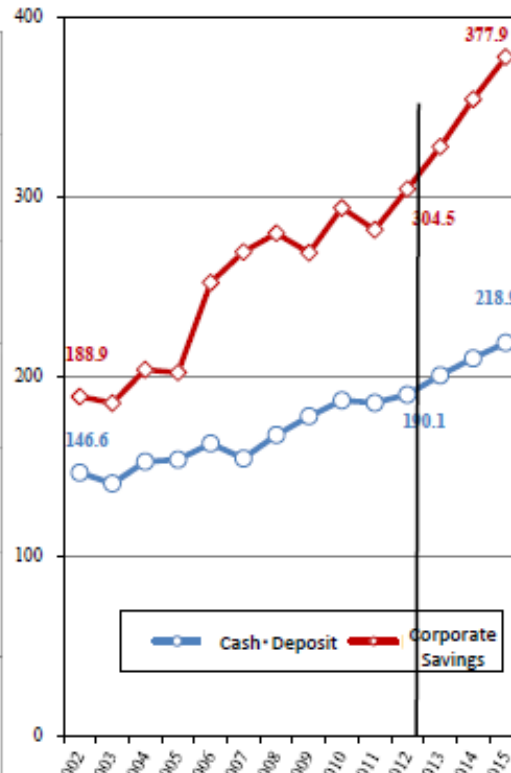
■ Reflecting mild pick up of macroeconomy, corporate earnings hit a record high. On the other hand, this positive aspect has yet to boost capital investment.

Change from previous year

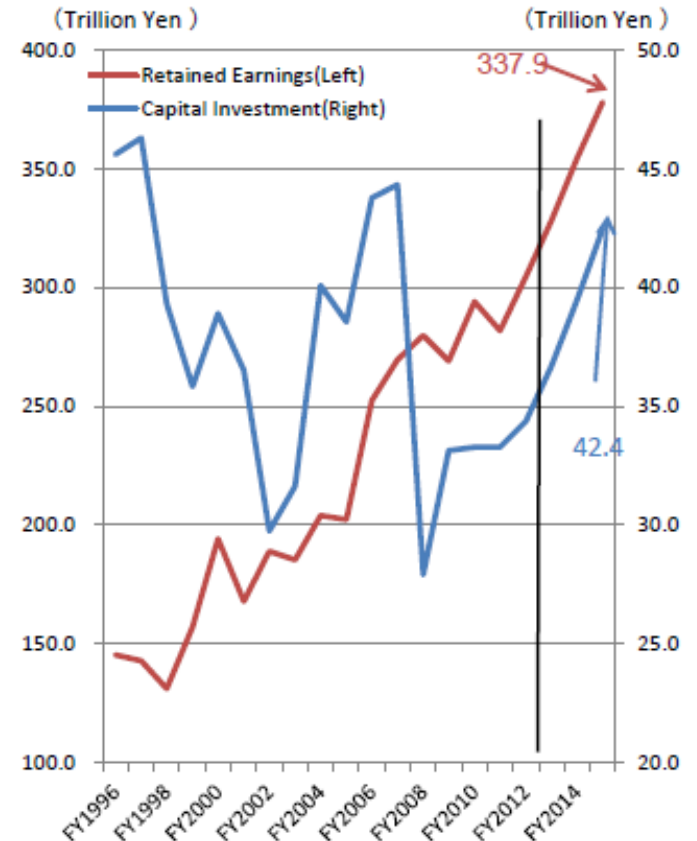
(%, change from the previous year)



Corporate Savings



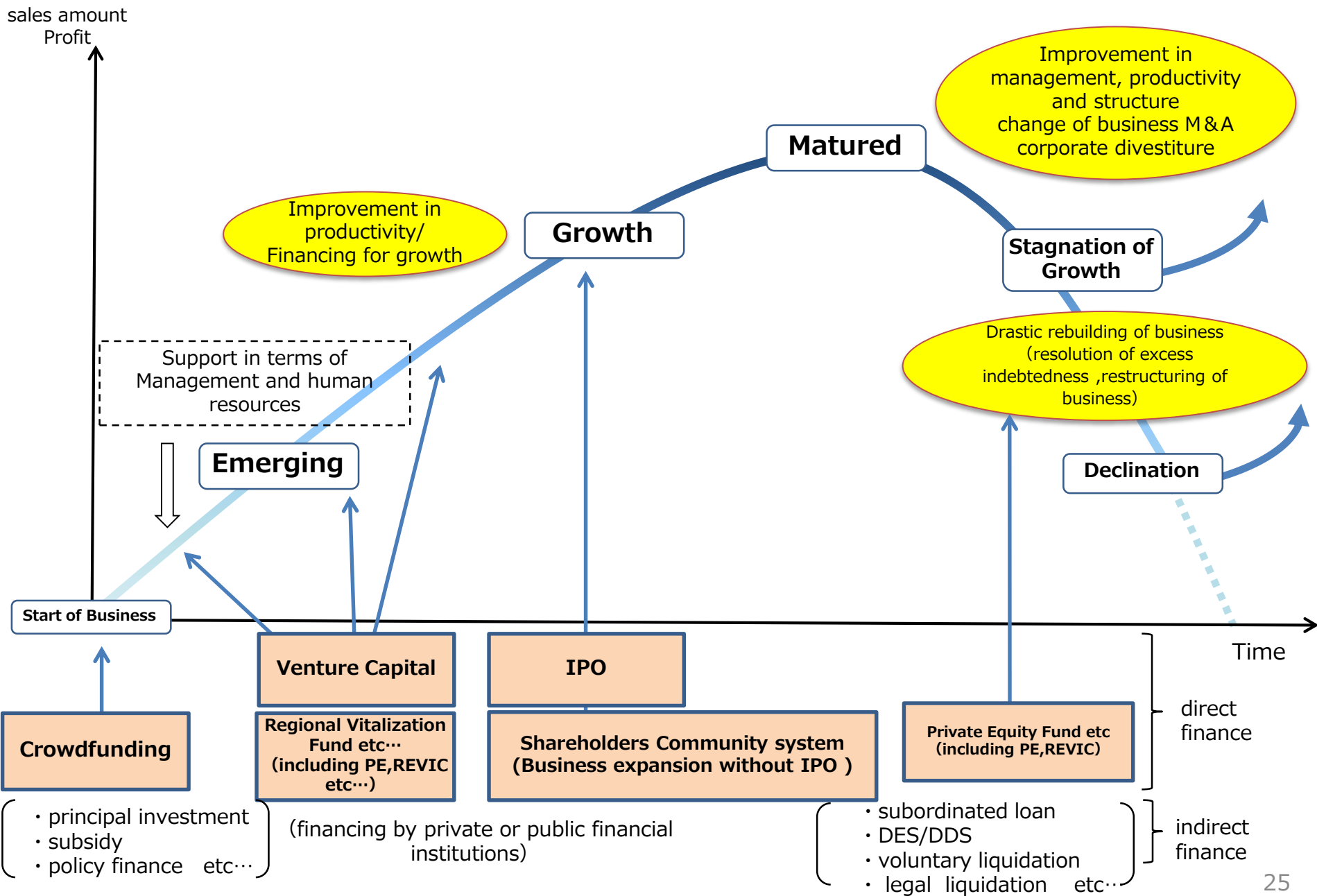
Total amount



2. Financing Growth Companies

- ◆ Investment by venture capital

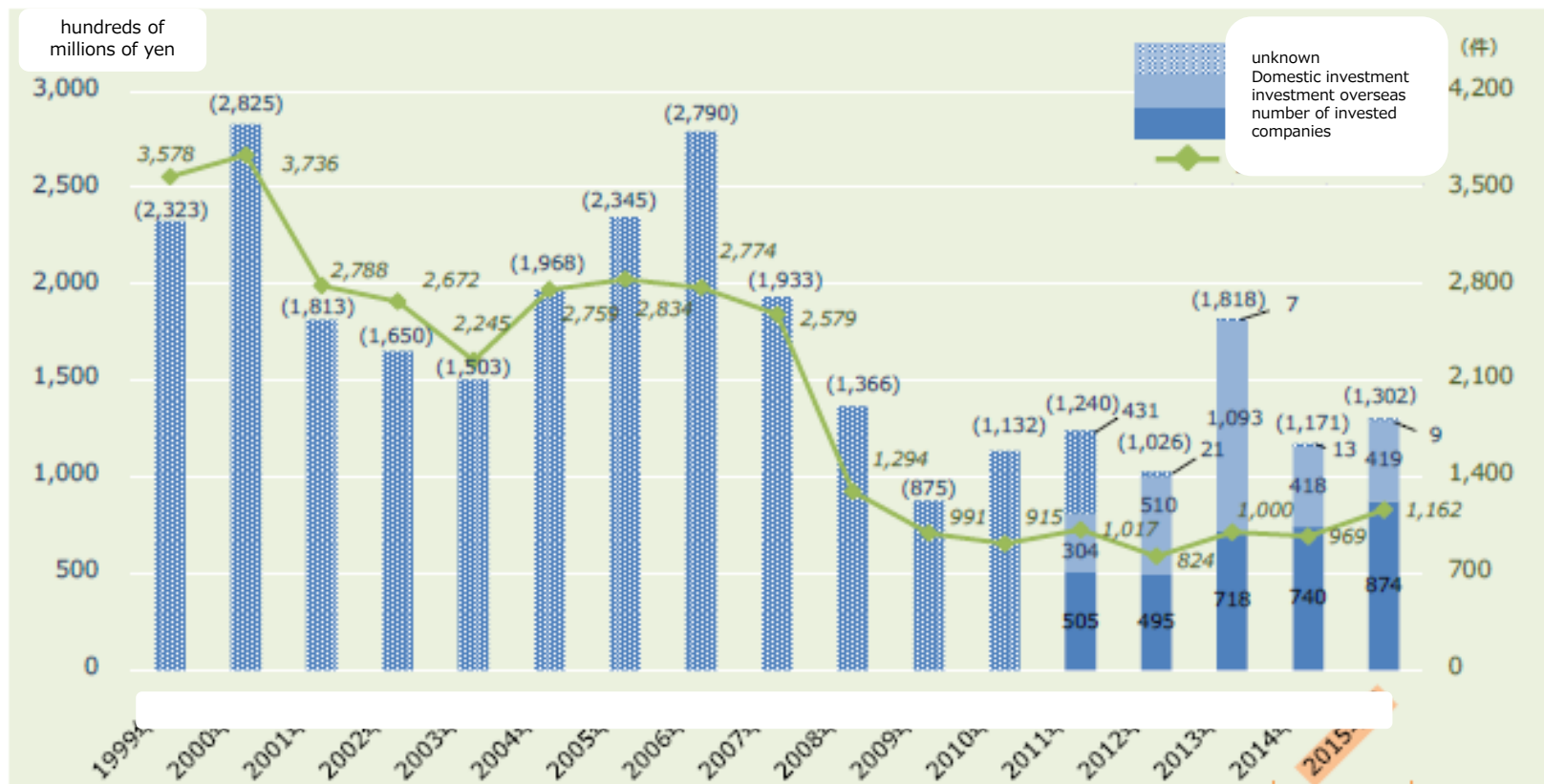
Supply capital to companies at various stages



Investment by Venture Capital(VC)

- The VC investments in 2015 has increased by 11.2 % and the number of invested companies also increased by 19.9% compared to 2014.
- The VC investments hit the bottom in 2009 and has started on a gradual recovery trend since 2010.

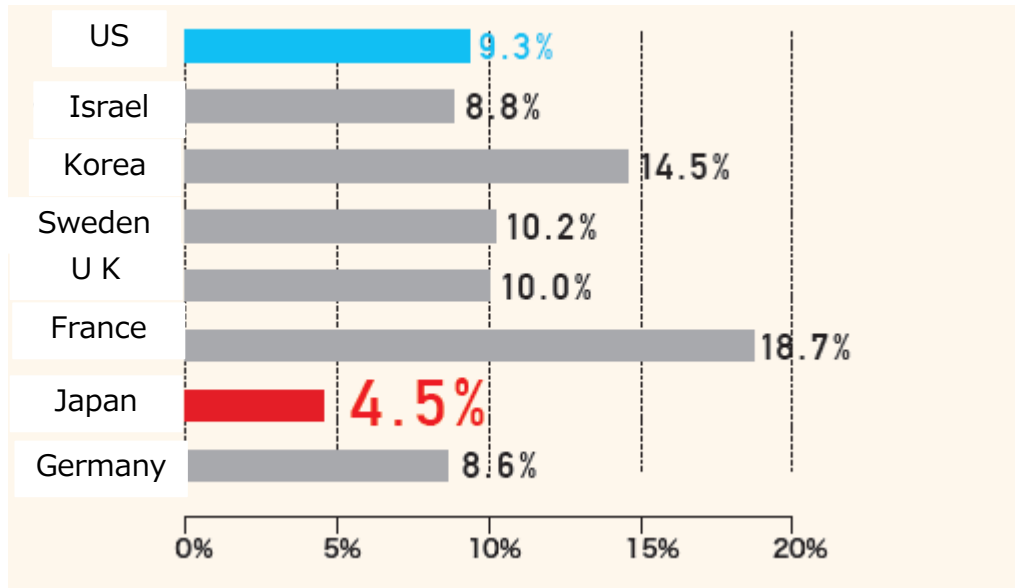
Investment by Venture Capital(VC)



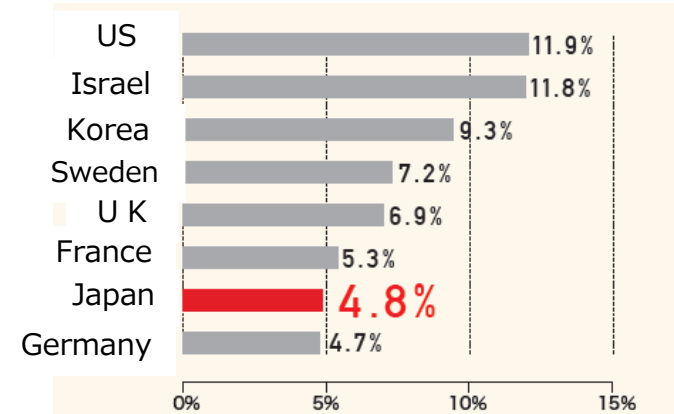
VC investment comparison (by county)

■ Business entry rate, the percentage of entrepreneurs and VC investment / GDP in Japan are at low level compared to other countries.

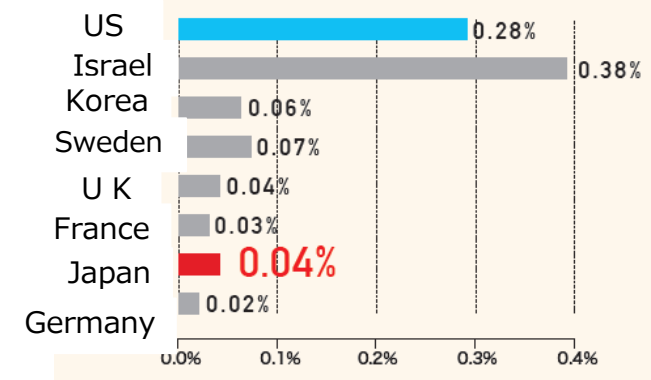
■ Business entry rate



■ Percentage of entrepreneurs



■ VC investment / GDP



Promoting “Growth Money” supply by various channels

Japan Revitalization Strategy (2016)

- III. Strengthening of the Power to Create Innovation Ventures and Creation of Human Resources full of challenge spirit
1. Strengthening of the power to create innovation ventures

Relevant KPIs

- ◆ Aim to increase companies' investments in universities and national research and development agencies by three times by 2025 (New KPI)
- ◆ At least 10 Japanese universities will be in the top 100 world universities in the next 10 years.
- ◆ Japan will become the No.1 global innovator within the next five years:
- ◆ Aim to increase the number of people eligible for annual salary or mixed-salary systems from 6,000 in FY2014 to 10,000 in FY2015
- ◆ Aim to allocate resources to reform initiatives at each university and maintain the percentage of the amounts affected at about 30-40% of the operation cost subsidies as at the end of FY2015. (New KPI)
- ◆ Aim to double nominal GDP as a percentage of VC investments in venture companies by 2022. (New KPI)

Promoting “Growth Money” supply by various channels

Revising Japan Revitalization Strategy(2015)

I Vitalizing of industries.

(3) Specific new measures to be taken

iv)Promotion of providing growth capital/risk money, etc.

- While using the system related to the investment type crowdfunding, to promote provision of risk money into local area, the Government will promote utilization of various types of crowdfunding in cooperation with "Home town investment" Association established by local governments and relevant stakeholders including regional financial institutions
- As a system to respond to fund provision to companies rooted in the region, and as a substitute for the Green Sheet Brand system, the Government will support financing by using "Shareholders Community system" (a system that enables solicitation for investment and trading between the members of the Shareholders Community formed by security companies to finance companies rooted in the region, etc.), which reduces the burden of timely disclosure.
- The Government will promote financing to local companies by utilizing "Regional Business Revitalization/ Business Reconstruction Fund“ funded and established by regional financial institutions, etc. in cooperation with the Regional Economy Vitalization Corporation of Japan (REVIC) aiming to support local healthcare industry, to revitalize local tourism/urban regeneration, to vitalize local core enterprises, and to support restoration and growth.
- Also, by using Private Equity Fund aiming to realize company growth and increase in value in growth fields and new technology development fields,

Local “Growth Money” Supply Forum

Point

- ◆ To facilitate growth money supply considering local economic financial situation,
 - ① exchange ideas about each local capital market situation and challenge
 - ② share good practices as to “Growth Money” supply

Members

- ◆ Managers of Local venture business, venture capital, the stock exchange, Security firms, regional financial institutions, and administrative authorities

Agenda

- 1 : Local equity market from the viewpoint of a local economic community
 - (1) Good practices and challenges according to stages of companies' growth
 - (2) Local “Growth Money” supply to local venture business

- 2 : Measures for “Growth Money” supply

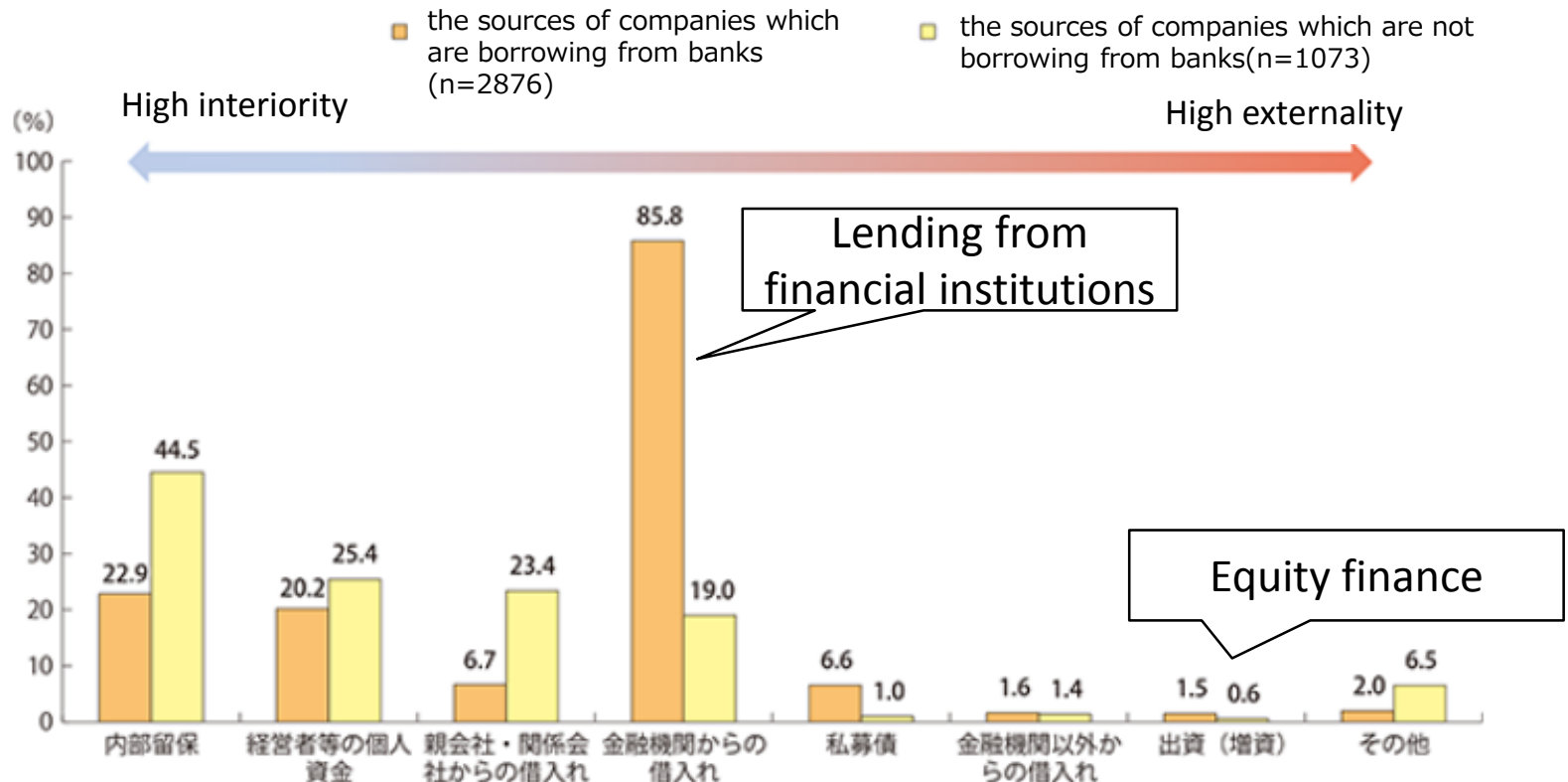
2. Financing Growth Companies

- ◆ SME financing and lending

SMEs financing

- In Japan, the way of financing for growth is mainly “bank lending”. The proportion of companies which adopt equity finance is small.

SMEs financing



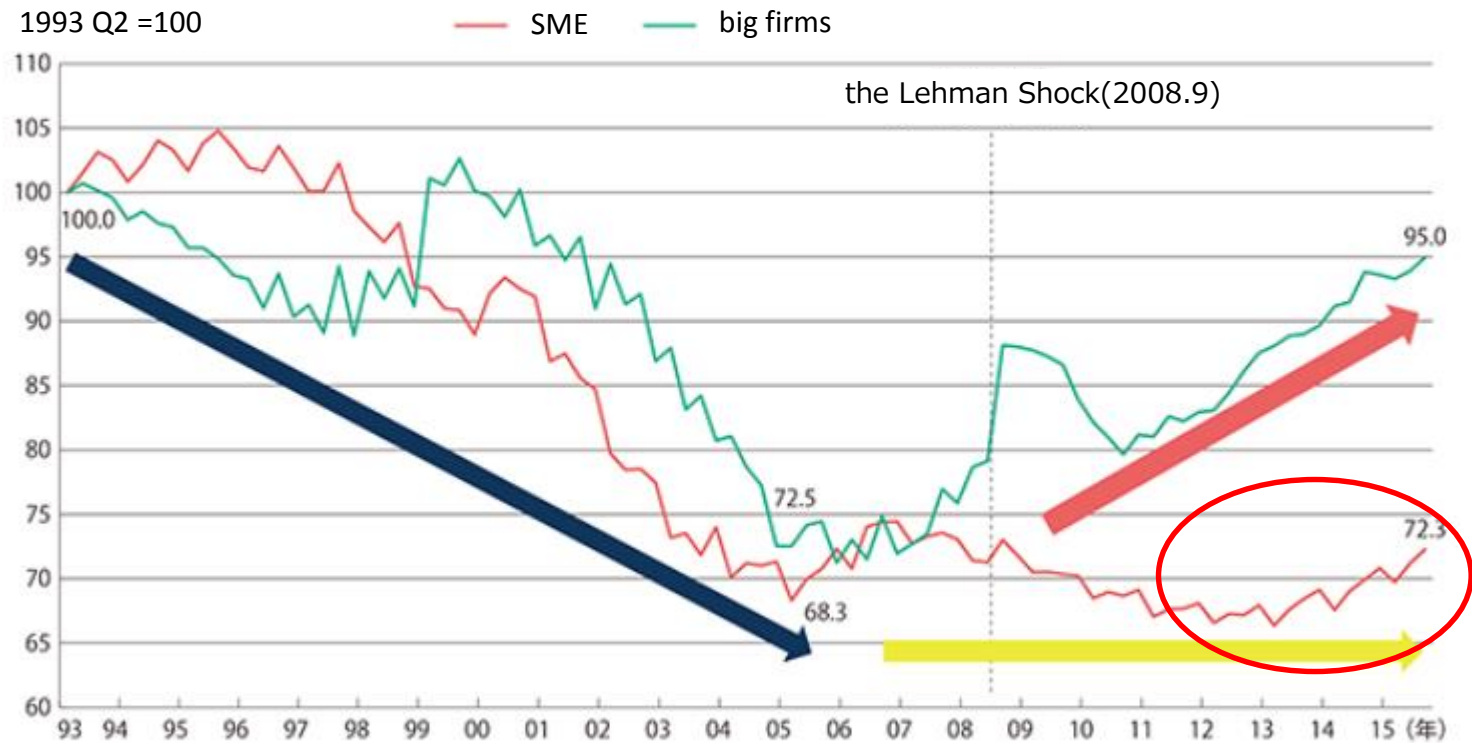
資料：中小企業庁委託「中小企業の資金調達に関する調査」(2015年12月、みずほ総合研究所(株))

(注) 複数回答のため、合計は必ずしも100%にはならない。

Domestic lending to large firms and SMEs

- After the Lehman Shock, lending to SMEs have not recovered.

Lending from financial institution



JFSA's approach

The JFSA encourages financial institutions to actively contribute

-to the creation of customer corporate values, the sustainable growth of the national economy, and the revitalization of local economies

-by supporting customers' efforts to enhance their business models and by underwriting loans relying on customers' future business prospects, not just on collaterals and guarantees.

《Former method of monitoring 》

Evaluation of soundness

Evaluating the soundness of financial institutions mainly through individual asset assessment in the onsite monitoring

Evaluation of soundness on the risk analysis of whole financial institutions

① respect the financial institutions' judgement in asset assessment

Lending by financial institutions tends to depend on the financial data, collateral and guarantee

Facilitating the lending on the proper evaluation of what business partners do

② facilitating lending , relying on customers' future business prospects, not just on collaterals and guarantees

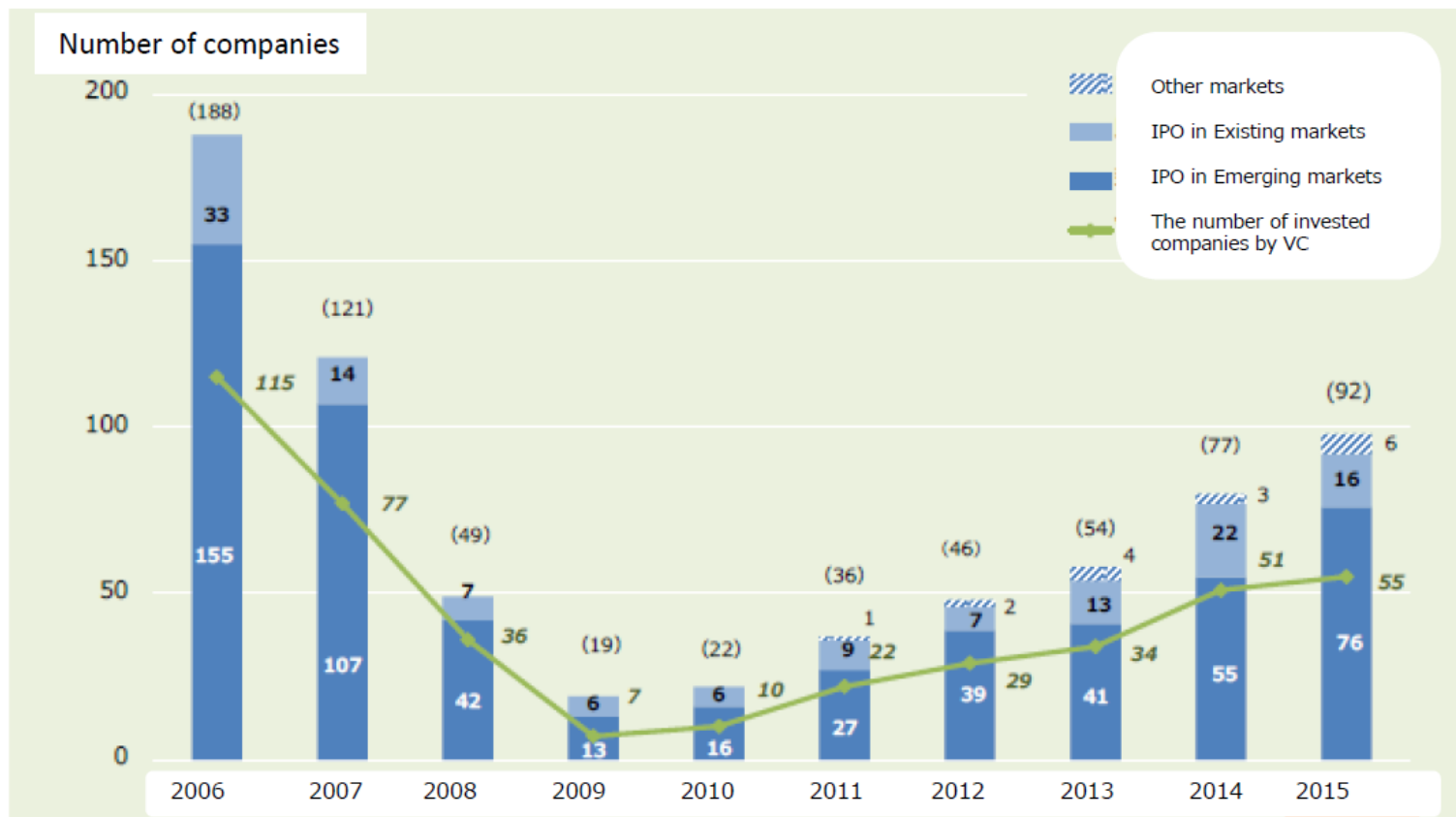
2. Financing Growth Companies

- ◆ IPO trend

Trend of IPO①

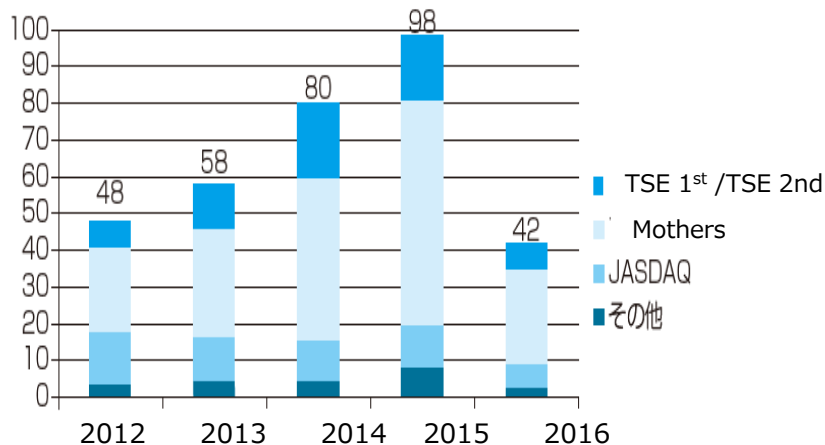
- The number of IPO drastically decreased in 2008 and has been on a gradual recovery trend since 2010 .

The number of IPO

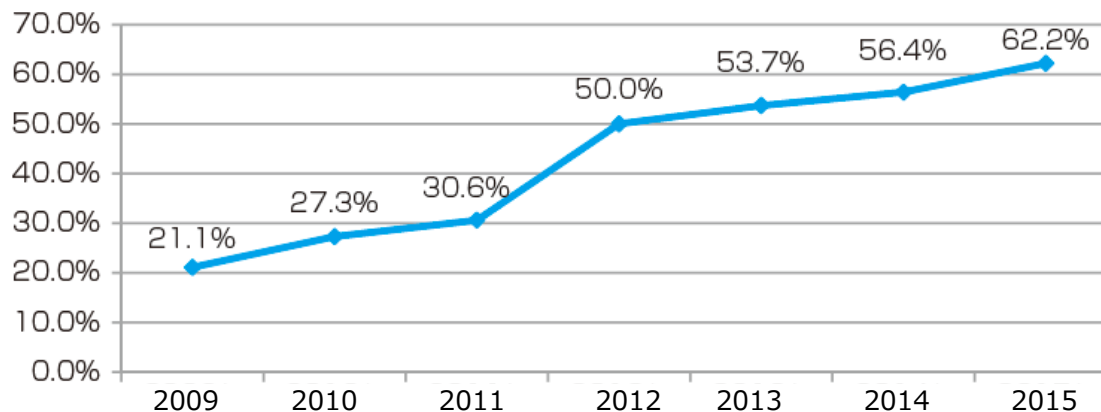


Trend of IPO②

- The number of IPO is increasing particularly in Mothers.
- First price which is said to be excessive has been moderated recently.



項目	Mothers			
	2013	2014	2015	2016
The number of listed companies	29	44	61	25
absorptive capacity (hundreds of millions yen)	605	1,067	1,387	358
absorptive capacity (average/hundreds of millions yen)	21	24	23	14.3
First price / public offering price	2.5	2.4	2.0	1.9



Stock Exchanges and Corporate Governance: the Italian Experience

Carmin Di Noia



OECD - Korean Ministry of Justice
Seoul
20 October 2016

EU multi-level framework

- EU company law
 - Non-systematic; mandates “comply or explain” on corporate governance practice
- National company law
 - Systematic; key governance issues (director duties; corporate groups)
- Corporate governance codes
 - Best practices; different source of legitimacy

The Italian CG Code and Committee

The Code:

- ❖ First released in 1999, revised in 2002, 2006 (updated 2010)
- ❖ New committee releases new code in 2011 (updated 2014, 2015)

The Committee:

- ❖ **SUPPORTERS**
 - Business Associations:
 - Banks (Abi)
 - Insurance Firms (Ania)
 - Corporations (Assonime)
 - Manufacturers (Confindustria)
 - Asset Managers Association (Assogestioni)
 - Italian Stock Exchange (Borsa Italiana)
- ❖ **MISSION**
 - Promoting best practices
 - Drafting and updating the Corporate Governance Code
 - Monitoring the implementation of the Code
- ❖ **COMMITTEE**
 - 24 members in charge for 3 years (meeting at least once a year)
 - Technical Secretariat and 3 experts assisting

The role of the Stock Exchange

- Co-founder of the CG Committee
- Chaired the CG Committee for its first 10 years
- Sets stricter governance rules for high-quality firms with high potential growth
 - STAR market segment (within the regulated market)
- While the CG Code does not apply to MTFs, Borsa Italiana sets governance requirement for AIM
- ELITE project: induction sessions for high profile, SMEs to facilitate access to capital markets

Standardized disclosure layouts

- Standardization may foster comparability
 - But it may trigger box-ticking, too
- Common format for the CG report with pre-defined layout for a limited set of key data
1. Format (Borsa Italiana) and guidance (Assonime-Emittenti Titoli) for the preparation of the CG report (both qualitative and quantitative info)
 2. Pre-defined tables only on (key) quantitative information (Assonime)

Standardized layout on selected topics

Board of Directors for the three year period 2014-2016 appointed by the Shareholders' Meeting on 15 May 2014									Control and Risks Committee ***		Nomination Committee ***		Remuneration Committee ***		Analysis of International Scenarios Committee ***	
Position	Members	Date of first appointment	Executive	Non-Executive	Independent Corp. Gov. Code	Independent Cons. Law on Fin. Intermed.	Attendance BoD meetings *	Other positions **	Members	* Attendance	Members	* Attendance	Members	* Attendance	Members	* Attendance
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Chief Executive Officer and General Manager	Mauro MORETTI	15/05/2014	X				14/14	0								
Director	Guido ALPA	15/05/2014		X	X	X	13/14	0	M	6/8	C	3/3				
Director	Marina Elvira CALDERONE	15/05/2014		X	X	X	13/14	0			M	2/3	M	3/6		
Director and Lead Independent Director	Paolo CANTARELLA ⁽⁹⁾	04/05/2011		X	X	X	13/14	0	C	7/8						
Director	Marta DASSU'	15/05/2014		X	X	X	14/14	1			M	3/3			C	3/3
Director	Alessandro DE NICOLA	15/05/2014		X	X	X	14/14	0					M	6/6	M	3/3
Director	Dario FRIGERIO ⁽⁹⁾	04/07/2013		X	X	X	12/14	3			M	2/3	C	6/6		
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An integrated monitoring approach

- ❖ Assonime-Emittenti Titoli [Report](#) on Corporate Governance in Italy
- ❖ Corporate Governance Committee Annual [Report](#)
- ❖ Consob [Report](#) on Corporate Governance

Assonime-Emittenti Titoli Report

- CG arrangements and practices (**statistics and analysis**)
- Since 2000
- Covers all Italian listed companies (**anonymous** data on an **individual** basis)

- The study is divided into two parts:
 - **Overview** of the corporate governance of listed companies
 - Part on **specific topics**

- Specific topics covered:
 - Structure and costs of the Internal control system (2008)
 - Directors' remuneration (2009)
 - Slate voting and minority representation (2010)
 - Procedures governing transactions with related parties (2011)
 - Directors' remuneration (2012, 2013, 2014, 2015)
 - Comply or Explain (2014, 2015)

CG Committee Annual Report

- Compliance with the CG Code (**analysis and recommendations**); since 2012
- The Report is divided into two parts:
 - **Overview** of the most significant governance issues and of compliance with CG Code
 - In-depth analysis on **specific topics**: board evaluation (2013); comply or explain (2014); board effectiveness (2015)
- Advice on compliance with CG Code's recommendations. Sometimes leading to CG Code **amendments**
- Since 2015, submitted to all Italian listed companies, together with a letter on areas of **possible improvement**

Consob Report on CG

- Structural features (mainly **statistics**)
- Since 2012
- Covers all Italian listed companies.

- Data about:
 - Ownership and control structure
 - Corporate boards
 - Annual general meetings
 - Related party transactions



The OECD-Asian Roundtable on Corporate Governance

“Public Enforcement and Corporate Governance: Guidance and Good Practices”



Ms. Fianna Jurdant
Senior Policy Analyst, OECD



Background

The *Reform Priorities in Asia : Taking Corporate Governance to a Higher Level* issued in 2011 identified promoting better public supervision and enforcement as one of the six priority areas

Business value of
good corporate
governance

Active, visible
and effective
enforcement

Improving board
performance

Enhance quality
of disclosure

Protection of
non-controlling
shareholders

Facilitating
shareholder
engagement

The report led to the establishment of an **Asian Roundtable Taskforce on Enforcement**, which worked a review of the legal framework and enforcement by capital market regulators in participating jurisdictions. The Task Force developed guidance on public enforcement in Asia.



The Public Enforcement and Corporate Governance in Asia Guidance and Good Practices

1st

First of its kind at a regional level.

14

Endorsed by 14 jurisdictions at the 15th meeting of the OECD Asian Roundtable on Corporate Governance on 12-13 February 2014 in Mumbai, India.

2013

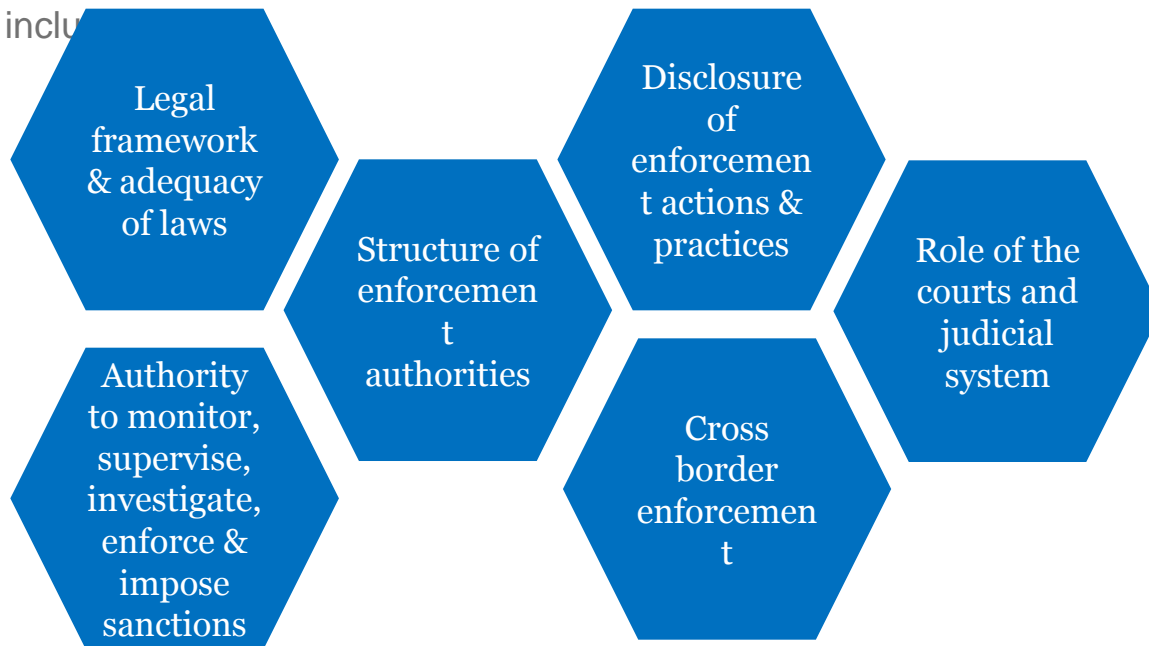
Study was conducted in 2013 through a questionnaire that was sent to the 14 Asian Roundtable countries; a report analysing the responses and an Issues Paper on Enforcement was presented to members of the Task Force in Kuala Lumpur on 4 June 2013.



The scope ...

Given the constituency of the Asian Roundtable, the focus was on public supervision and enforcement.

Areas covered include





Legal framework and adequacy of laws

Issues

Family or state-run business groups

Complicated network ownership structures

Opaque structures; difficult to identify beneficial owners

Awareness on fiduciary duties of directors

Recommendations:

- There should be **comprehensive requirements** for RPTs to prevent abuse and penalize wrongdoers. The requirements should set clear thresholds for disclosure, obtaining approvals, and include procedures for ensuring the reasonableness of transaction costs.
- Beneficial owners who have crossed the threshold of ownership should be required to **disclose ultimate beneficial ownership arrangements**, including acting in concert arrangements
- Directors' **fiduciary duties** should be explicitly highlighted, and the board of directors should establish clear roles and responsibilities when complying with their fiduciary duties.



Structure and capacity of enforcement authorities

Issues

Fragmented or concentrated enforcement structure

Independence of enforcement authorities

Checks and balances to ensure power is exercised properly

Recommendations:

- Countries with multiple enforcement authorities should have a Memorandum of Understanding to **formalize co-ordination** and should have frequent meetings to discuss enforcement issues.
- Demutualized stock exchanges should ensure **independence of their regulatory function** through being subjected to oversight by a statutory regulator or equivalent independent body.
- There should be a **right to appeal** from or a review of the decision of enforcement authorities, including in courts of law.



Authority to monitor, supervise, investigate, enforce and impose sanctions

Issues

Sufficient powers of investigation

Range of enforcement powers and tools

Recommendations:

- Statutory regulators should be given **adequate powers** to amongst others: prosecute criminal cases, investigate breaches falling within their jurisdiction, decide the type/mode of proceedings (i.e. administrative, civil or criminal) in effective enforcement of a breach.
- Statutory regulators should be given **adequate support** by other authorities or regulators who have an obligation to grant assistance.
- Regulators should be given powers to take **pre-emptive action**, and to have the power to impose a wide range of sanctions.



Disclosure of enforcement actions and practices

Issues

Transparency of enforcement actions

Promote greater accountability of the regulators

Better understanding and awareness of the roles and actions of various enforcement authorities

Recommendations:

- Regulators should **disclose** their enforcement philosophy, objectives, internal structures, legal powers and procedures used to address cases.
- Regulators should **annually provide details of enforcement actions** and should disclose the outcome of court actions including out-of-court settlements as soon as they are able.
- Regulators should ensure **adequacy of information in disclosure of enforcement actions**, including the basis of such actions.



Courts and the judicial system

Issues

Credible, independent and efficient judicial system

Judges' and prosecutors' expertise in corporate governance matter & financial rules

Recommendations:

- **Specialised business courts** should be established and staffed with adequately remunerated judges and prosecutors trained specifically in capital market laws and procedures to enable them to prosecute and dispose of complex cases efficiently.
- The **judiciary should be independent, with integrity and respect for the transparency** of the judicial process. Decisions should be published.
- Ongoing **training should be a permanent feature** to build credibility and competence of the judicial process.



Cross-border enforcement

Issues

Internalisation of capital markets

Ensuring effective cross-border co-operation

Recommendations:

- Cross-border co-operation should be improved through **bilateral and multilateral arrangements**.
- **Inter-agency meetings and working committees** should be established among regulators from different jurisdictions.
- **Information sharing provisions in national laws** should be reviewed to enhance cross-border co-operation.



The Governance of Regulators, Public Enforcement and Behavioural Economics

OECD ASIAN Roundtable on Corporate Governance

Faisal Naru, OECD,
With Filippo Cavassini, OECD

24-25 October, Seoul

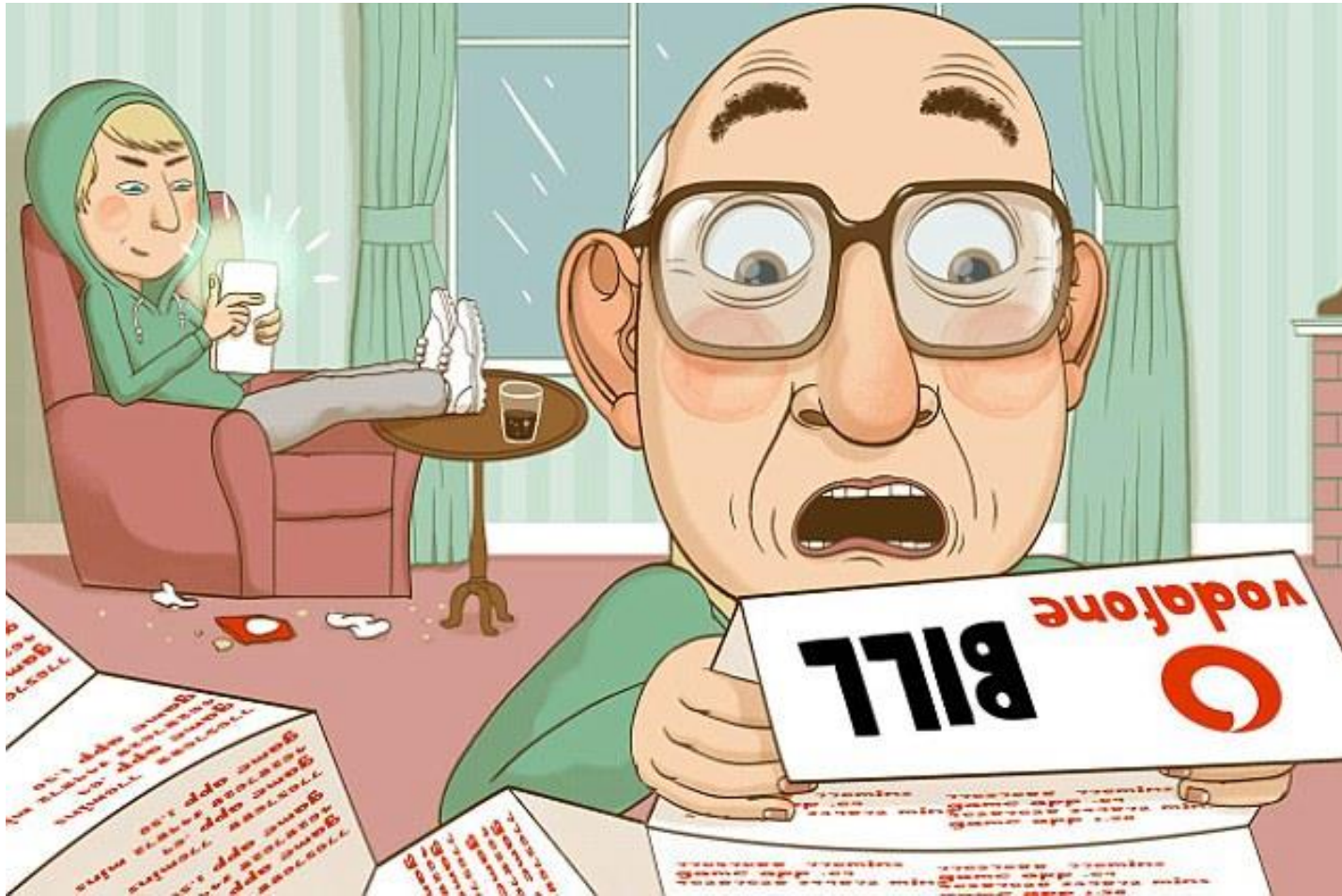


Agenda

1. What is behavioural economics/insights and why is it being used?
2. Why is Governance important for regulators?
3. What does this mean for public enforcement?



1. Evidence from Behavioural Insights for Policy Making – The case of Colombia





Colombia Communications Market

Republic of Colombia, Article 6 of Resolution 3066/2011

Principle of Information

At all times, during the provision of services upon the conclusion of the contract and during its execution, through mandatory user support mechanisms referred to in paragraph 11.9 of Article 11 of this resolution, the communications service provider should provide the user with all the information associated with the conditions of provision of services, rights, duties and rates on the services are provided.

For that purpose, it shall provide such information in a **clear, transparent, necessary, truthful** and previous, simultaneous and timely anyway, sufficient, verifiable, accurate, certain, complete and free of charge manner, and not misleading, to the effect that users make informed decisions about the service or services offered and / or required.

Communications service providers shall comply with all of the duties of information contained in this system, providing the user with access to the information required by this resolution, through the physical customer service offices, the virtual customer service offices (the provider's website and social network page through which the RCAs are shown), and free customer service lines.



Evidence of actual behaviours used in report

School of Psychology at the Konrad Lorenz University foundation, Colombia

- 25 Consumer psychology exercises
- Across 17 regions of Colombia
- 3,700 responses

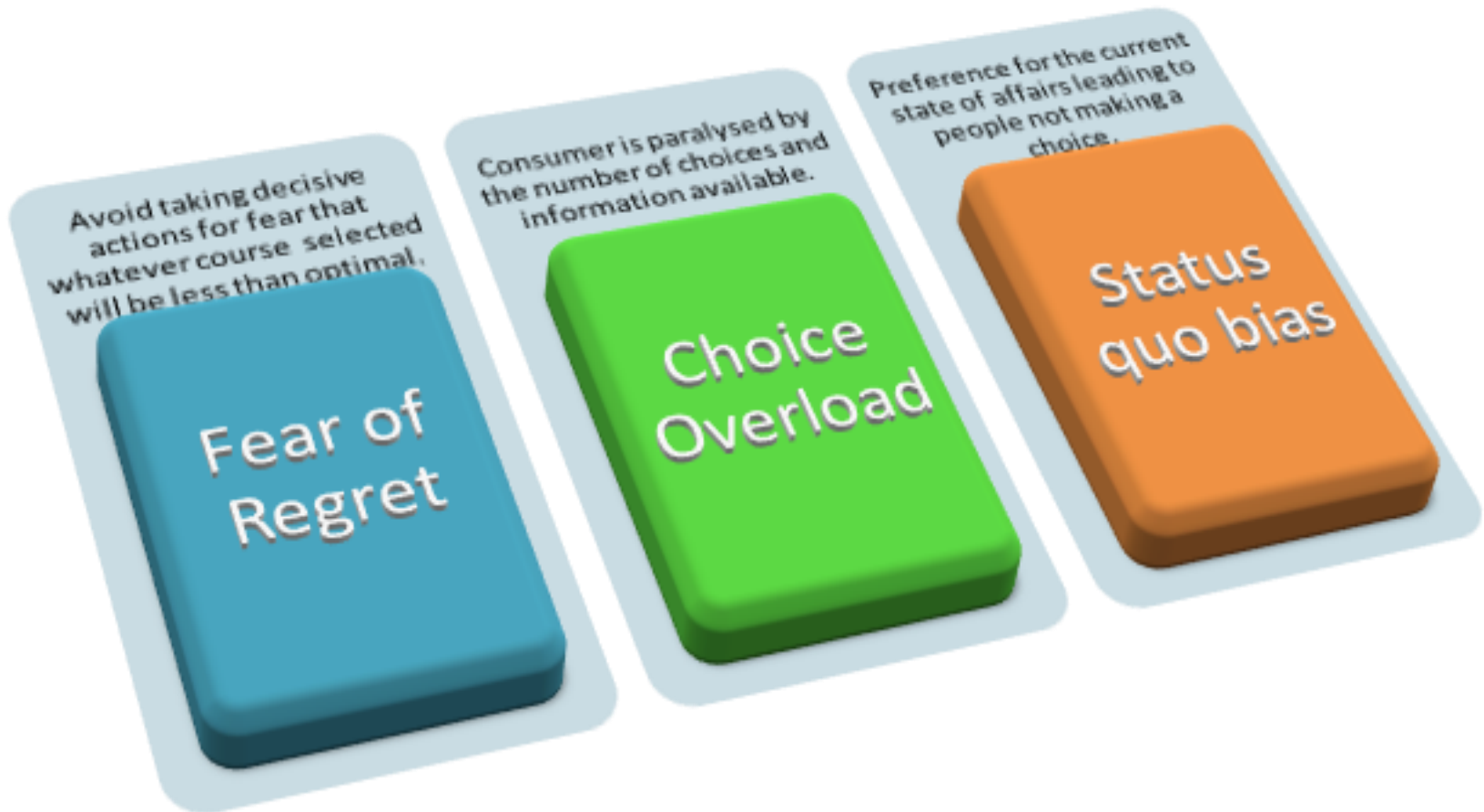


Too much information: What does empirical evidence tell us?

- As choices increase, consumers opt for extreme choices (basic or fully loaded).
- Reducing complexity can only work if integrated into decision context.



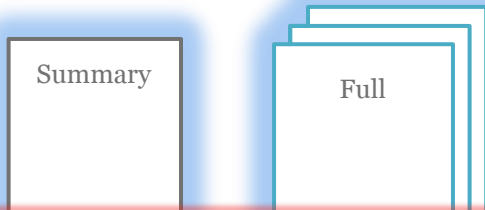
Too Much Information: Reduction in cognitive ability by 10-20%



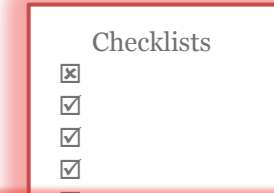


What does this mean for Policy?

Disclosure

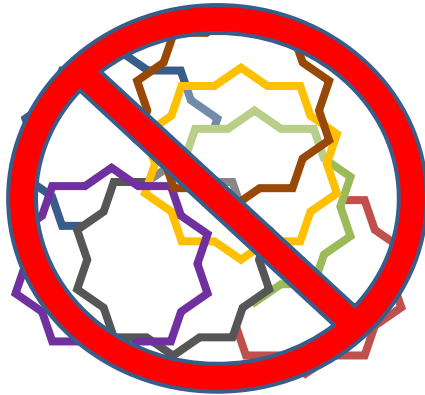


Choice Aids



Regulate or not to Regulate?

Reduce Choices



“Just in time”



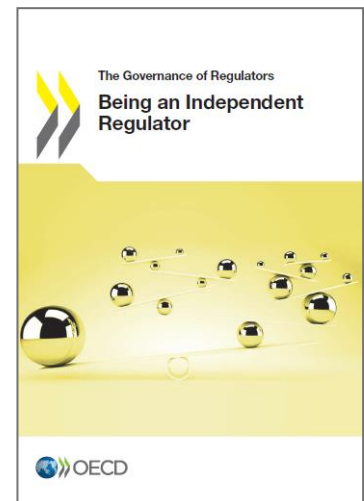
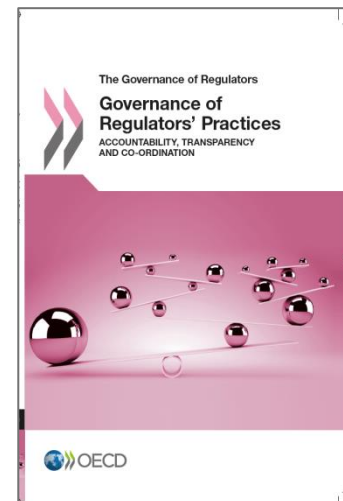
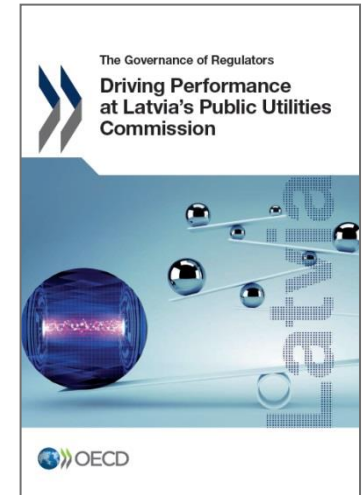
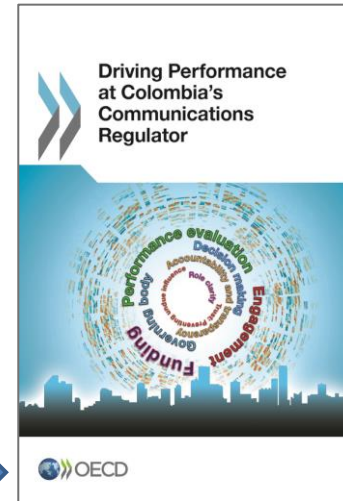


2. Why is Governance important for regulators?





#1: Good governance drives Performance





Measuring outcomes is a key feature of a world-class regulator

Assessing the impact of regulatory actions and decisions to drive improvements

Supporting transparency and accountability to public institutions

Building trust and confidence of investors and citizens by tracking tangible results

Importance of performance measurement methodology recognised by a number of OECD regulators...



#2: Good governance protects from undue influence

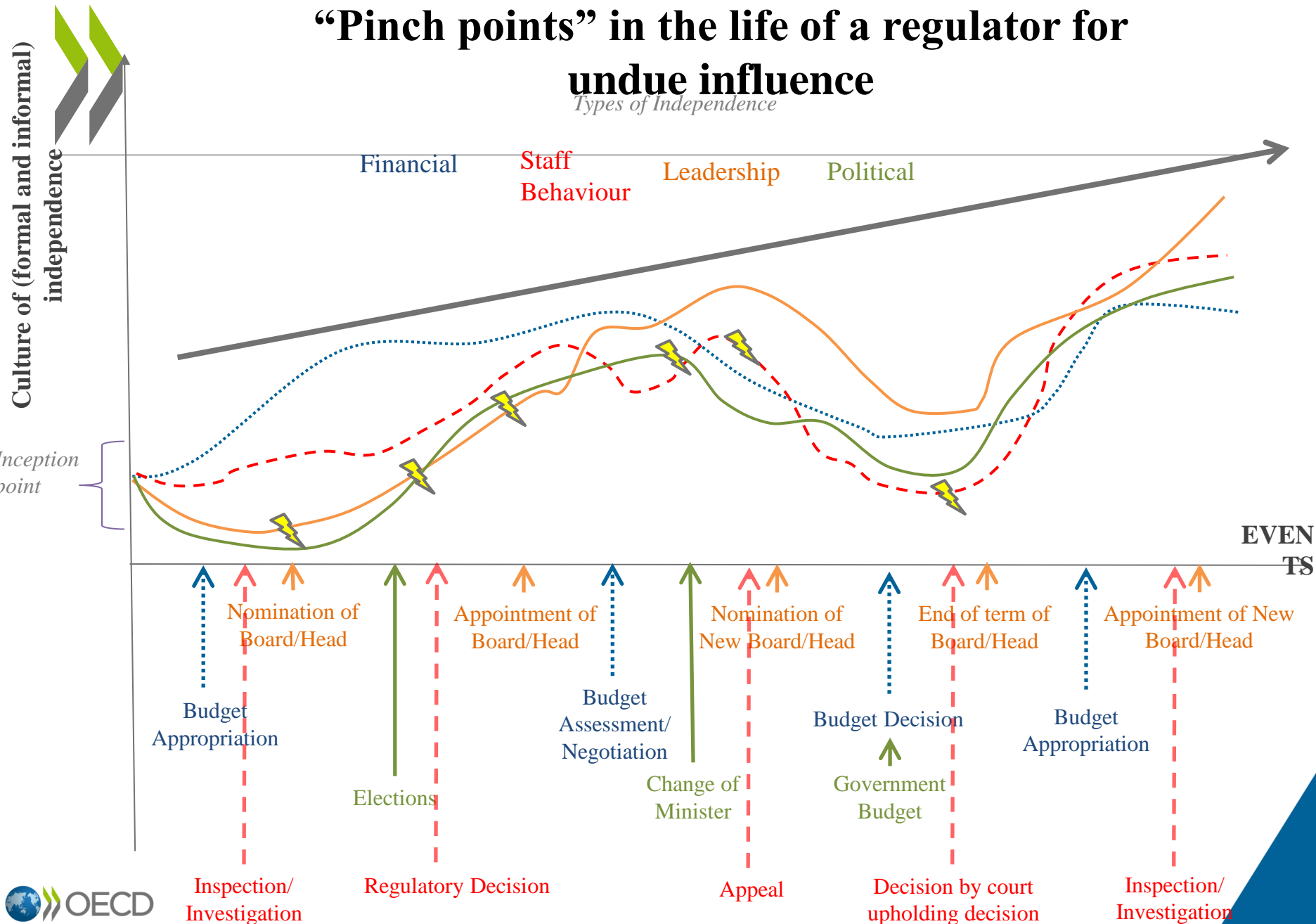
- OECD work on protecting public institutions from “undue influence”.
- Influence is necessary – not
- “Pinch point analysis” for developing culture in regulators – forthcoming publication from OECD Network of Economic Regulators



(see <http://www.oecd.org/gov/regulatory-policy/ner.htm>)

“Pinch points” in the life of a regulator for undue influence

Types of Independence





What does this mean for Public Enforcement?





What does this mean for Corporate Governance in Asia?

- Adequate legal framework (e.g. related party transactions, ownership, fiduciary duties of directors)
- Various institutions often share enforcement of corporate governance.
- Statutory regulators should be given adequate powers;
 - Stock exchanges often CAN impose civil sanctions ranging from caution letters, private or public reprimands, fines, suspension or de-listing among others;
 - Capital market statutory regulator (Securities and Exchange Commission or its equivalent), may seek to impose criminal remedies through the judicial process.
- Regulator should receive adequate support/cooperation from other relevant bodies.
- Regulator should be transparent, accountable and report on enforcement



Enforcement Possible? Compliance?





Understanding (risk) behaviours is important for enforcement

1. People are capable of acting against their own financial interests where they perceive unfairness (risk negative consequences through non-cooperation)
2. Most individuals are generally willing to incur costs for the greater good provided they are confident that others are doing the same.



Behaviourally informed enforcement

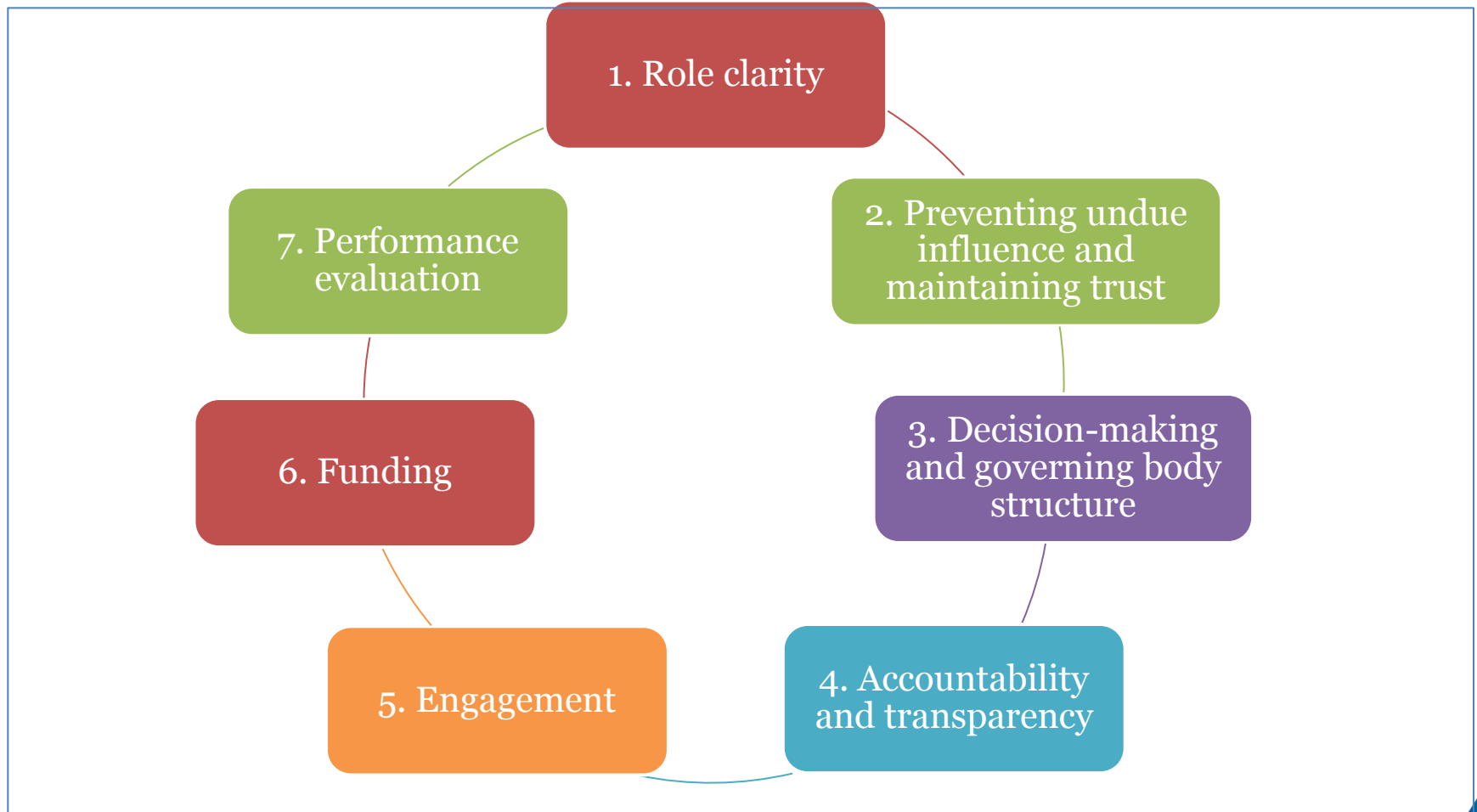
In 2009 HM Revenues and Customs in the UK also conducted research into segmenting their market to increase compliance and reduce the cost of non compliance (HMRC, 2009). They found that the four possible dimensions of segmentation were awareness of one's obligations, motivation to comply, ability to comply and opportunity not to comply.

They found that

- ✓ 8% of their regulated subjects were unaware;
- ✓ 12% were reluctant conformists;
- ✓ **4% were “dodgers”;**
- ✓ 18% needed help; and
- ✓ 58% were willing conformists



Institutional (Behaviour) Governance for Better Outcomes





Thank you

Happy to take questions!

Faisal.naru@oecd.org



Follow me on Twitter: [@faisal_naru](https://twitter.com/faisal_naru)



Lets Link: www.linkedin.com/in/faisal-naru

For more information:

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