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Published by
Global Legal Group Ltd.
59 Tanner Street
London SE1 3PL, UK
Tel: +44 20 7367 0720
Fax: +44 20 7407 5255
Email: info@glgroup.co.uk
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General Chapters:

Country Question and Answer Chapters:

A Global Governance Framework For Company Directors

Deloitte LLP

Robert J. Kueppers

Global business conditions remain challenging, regulatory change continues in most countries, and shareholder demands for sustained growth remain high. As senior executives struggle to maintain and improve organisational performance in these circumstances, they depend more than ever on the board of directors for sound corporate governance.

Yet corporate governance has become increasingly complex in recent years. Although the complexity varies with country and industry, directors generally must be aware of more activities, more regulations, more risks, and more stakeholders than in the past. For that reason, a number of boards have developed or adopted a governance framework – a step that many other boards might well consider. Such a framework helps the board to define and organise its responsibilities for governance and management oversight and to clearly distinguish its role in relation to management.

This article presents a practical, demonstrated governance framework that can be used by a board of directors seeking to fulfil its oversight responsibilities while assisting management in creating and sustaining long-term shareholder value.

Specifically, Deloitte's Global Governance Framework is designed to assist directors in their efforts to:

- Define and assert the board's governance responsibilities.
- Delineate the lines between board responsibilities and management responsibilities.
- Understand new governance responsibilities as they emerge.
- Decide how best to fulfil their governance responsibilities.

The Deloitte framework is "global" in that it can be applied by boards in most industries within and across countries and jurisdictions. It can also be applied by boards within a single-tier (or unitary) system of non-executive and executive directors, within a two-tier system of a separate supervisory board of non-executive directors and a management board of executive directors, and within a mixed system of two separate boards that have the same chairman or CEO and executives. This framework is applicable to directors in businesses of most sizes, ranging from domestic companies in a single line of business to complex multinational organisations operating in multiple lines of business.

Specific governance responsibilities will, of course, vary by industry and country. Entity structures, accounting rules, auditing practices, financial disclosure requirements, shareholder rights, board and management legal duties and liabilities, and corporate social responsibilities will vary as well. However, basic governance responsibilities remain remarkably similar across borders and around the world. Typically, these may include the board's responsibility to:

- Represent the shareholders and their interests *vis-à-vis* management, which usually includes hiring or approving the hire of the chief executive officer (CEO).
- Oversee management's goals, strategies, plans, decisions, and activities with an eye toward their impact on the value of the company.
- Oversee the company's risk management policies and practices and risks to the organisation.
- Oversee accounting, financial reporting, and auditing practices, and disclosures to shareholders and the investing public.
- Obtain assurance or otherwise ascertain that the company is being operated in compliance with legal and regulatory requirements.
- Oversee management's operational and financial performance.

To fulfil these general responsibilities, directors must translate them into specific areas in which the board participates actively or in an advisory capacity with regard to management. For example, the board has valuable roles to play regarding organisational strategy and performance, and in maintaining the company's talent and integrity. It also has a role to play in overseeing reporting and compliance. By defining its roles and responsibilities in specific areas, the board can translate the general responsibilities listed above into specific governance and oversight activities supported by policies, processes, and practices for fulfilling those responsibilities.

The Need for a Governance Framework

In practice, governance means neither "policing" management, nor automatically approving management's decisions. It means working collaboratively to review and advise management on strategies, plans, decisions, and activities. When appropriate, it means questioning and challenging management decisions and actions from a more objective viewpoint than management's – one informed more by both shareholder and public interests.

The vast majority of directors understand this. Yet many struggle to keep up with evolving regulations, shareholder demands, public interests, and issues in risk management, finance, and technology. Many also continually seek the correct balance between collaborating with management and challenging management.

For example, many directors repeatedly face the following questions, in one form or another:

- Which regulatory and marketplace developments are now most likely to impact the organisation?
- How should we be allocating our limited time?

- How do we best partner with management while ascertaining legal and regulatory compliance?
- What should we be doing in the most critical areas of oversight?
- How does the work of board committees (if present) relate to that of the full board?
- Where do we need to increase our expertise and skills?

A governance framework can help directors to answer these questions. It can provide the basis for them to improve their individual and collective understanding of the evolving demands they face, and help them to enhance their ability to fulfil their roles and to distinguish those roles from management's. It can also provide a structure for organising the board's annual calendar, meeting agendas, committee charters, and other tools and activities. It can help the board to pinpoint areas where it needs to bolster governance or oversight. For instance, four attributes help the board assess its performance level and put a governance framework into action: skills and knowledge; process; information; and behaviour. These attributes can assist the board in identifying strengths and opportunities for improvement within each of the governance elements.

Ultimately, a governance framework provides a guide for a board to use in defining, developing, and deploying the elements of its corporate governance infrastructure – the policies, procedures, and processes by which it fulfils its many governance and fiduciary duties. It can also position a board to address its responsibilities in reference to a corporate governance code or regulation to which it may be subject or voluntarily decides to adopt.

Characteristics and Caveats

The Deloitte Global Governance Framework provides a concise yet thorough view of board responsibilities. At a high level, it distinguishes between decisions and activities of managing the business (management's responsibility) and exercising oversight of those decisions and activities (the board's responsibility).

However, the framework should not be misinterpreted or applied in unintended ways. Chiefly, this calls for noting the following characteristics and caveats regarding the framework:

- ***It is not meant to be prescriptive***. The framework should be tailored to fit the company's needs. Regulatory and legal requirements vary based on industry and country, and needs may differ depending on the ownership structure and stakeholder expectations for each entity. There is no "one size fits all" approach for a system as complex as corporate governance.
- ***It does not replace existing internal governance models***. The framework aims to connect existing organisational governance models, such as those related to risk, compliance, and internal controls, not to replace them. In this way, the framework helps directors and managers to develop an integrated view of the activities within the company's governance system. In addition, the framework can help directors and managers to define their respective roles and responsibilities within existing models and to identify gaps and areas for improvement.
- ***It is not a tool for assessing legal or regulatory compliance***. Although legal and regulatory compliance are integral to segments of the framework, the concepts presented in the framework go beyond compliance with laws and regulations to encompass attributes of an effective governance programme.

This framework is presented as a guide and as a means of conceptualising, categorising, and organising governance responsibilities. Other governance frameworks also have useful characteristics, as well as limitations. It is up to the board and management to adopt or develop the framework that best addresses the company's needs.

The Framework and its Parts

Whether the board and management adopt a framework or develop their own, the governance framework should articulate the elements of the governance programme and clarify the respective roles of the board and management. These attributes guided development of Deloitte's framework (see Figure 1). Deloitte developed this framework based on the collective knowledge of its professionals and of boards and management teams, and submitted earlier versions for review by members of the governance community.

Figure 1. Deloitte's Global Governance Framework

Referring to Figure 1, board governance encompasses the entire framework and indicates areas in which the board's role transitions from active participant to active overseer (as indicated by the fading arrows). Within the framework is the corporate governance infrastructure, the means by which governance is implemented. This infrastructure comprises the people, processes, and technologies that management has put in place to govern the day-to-day activities of the company, as well as the processes used to accumulate information and report it to the board and external stakeholders.

The segments in the top half of the framework are those in which the board plays a "hands-on" role: organisational performance; strategy; governance; talent; and integrity. While the board exercises oversight in these areas, it is generally not considered enough for directors only to understand and monitor them. Instead, the board is an active participant in these areas. This participation may be prompted by organisational or industry demands, legal or regulatory requirements, or stakeholder expectations. In addition, some duties and decisions related to these areas cannot be delegated to management.

For each of these areas, the board has key objectives and activities, which can be described as follows:

- ***Governance***: The board establishes structures and processes to fulfil its responsibilities in light of the perspectives of investors, regulators, employees, management, and other stakeholders. The board selects its members and leader(s) by means of an inclusive, independent, organised process aligned with company strategy.

- ***Strategy***: The board advises management regarding strategic priorities and plans aligned with the mission of the organisation and the best interests of stakeholders, and with an appropriate short-, mid-, and long-range focus. The board also actively monitors management's execution of approved strategic plans and the adequacy and transparency of internal and external communication of strategic plans.
- ***Performance***: The board monitors management's execution of strategic and operational plans against budgets and in alignment with the strategic goals. This includes performance in operational, financial, risk management, and other key areas.
- ***Integrity***: The board sets the ethical tenor for the company, and participates in governance programmes designed to promote legal and regulatory compliance and appropriate ethical standards throughout the organisation.
- ***Talent***: The board selects, evaluates, and compensates the CEO and oversees the talent programmes of the company, particularly those related to executive leadership and potential successors to the CEO. The board communicates executive compensation and succession decisions clearly and comprehensively.

While the above areas are those in which the board provides more active involvement, as opposed to pure oversight, those in the lower half of the framework are no less important. These are areas in which management holds primary responsibility, and they include the following:

- ***Planning***: Management develops strategic, financial, operational, and other plans aimed at achieving organisational goals. These generally relate to growth in revenue, profits, and other measures related to shareholder value. However, they also include plans for sustainable business practices, catastrophic-event response planning, and the like.
- ***Operations***: Management executes plans through operations related to production, sales, marketing, distribution, risk management, human resources, finance, and other functions across the company and within specific businesses.
- ***Reporting***: Management reports operating results to shareholders and the public through financial and other reports, usually specified by regulatory authorities and securities exchange listing requirements, informed by local business customs.
- ***Compliance***: Management designs and operates internal controls and other methods and tools for conducting operations in compliance with legal and regulatory requirements.

In each of these four areas, the board provides advice as well as oversight of management's decisions and activities. For example, regarding operations, the board (through the board charter) possesses or may assert or obtain the power to decide which items should come to its attention, such as transactions or risk exposures over a certain amount. In some countries, regulatory, legal, or securities exchange requirements may call for the establishment of specific board committees to oversee some of these areas, such as an audit committee which oversees control functions, financial statements, and disclosures.

Although these areas may be defined differently by different organisations, there should be a clear distinction between the areas in which the board is actively participating and those in which it provides mainly active monitoring, advice, and oversight.

An example may further clarify the distinction and the relationship between responsibilities in the upper and lower halves of the segmented circle. Some directors believe that the most important role the board plays is the selection of the CEO. In this activity, the board is not simply overseeing a management process, but also leading the process itself. The board cannot delegate selection of the CEO to management.

However, hiring the CEO is one of many activities within the area of talent and many talent-related decisions are delegated to management. Management is responsible for the talent management infrastructure, such as employee incentive and compensation plans, selection and evaluation procedures, and performance remediation and employee termination policies. The board is responsible for overseeing the talent management infrastructure. Working together, the board and management develop policies, processes, and practices to attract and retain the talent the organisation requires to implement its strategies and accomplish its goals. The board delegates most talent-related governance responsibilities to management, but it is responsible for hiring and compensating the CEO.

At the Core: Risk and Culture

Governance activities emanate from risk and corporate culture, the core of this framework (see Figure 1). Indeed, an organisation's success is, in large part, driven by how wisely it takes risks, and how effectively it manages the risks it faces, all of which occurs in the context of the enterprise's culture. With boards taking a more active role in risk oversight, it is essential that board members understand the risks and risk management issues that affect strategic decision making and long-term success. That understanding can fuel the robust conversation that directors and managers should be having about risk, risk governance, and risk management.

Culture represents the intersection of risk, and board and management activities. In everything from its selection of the CEO to the questions it poses to management, the board helps set the tone for risk taking and risk aversion *and* for the overall corporate culture. Similarly, in the businesses it pursues, the manner in which it pursues them, and the people whom it hires, management creates and maintains a certain posture toward risk and creates and reinforces a certain organisational culture.

Thus, the oversight of risk and culture form the core of corporate governance. As a result, and in light of current business conditions, directors may need to enhance their knowledge of risk and of the risks the organisation faces. These risks may extend beyond those that the board and management usually consider. They may go beyond strategic, operational, financial, compliance, and similar risks to include new regulatory, legal, political, and social media risks, as well as cyber threats and risks to intellectual property, brand, and reputation.

Risk management is tightly linked to organisational culture and affected by the values of the entity, the motivations of personnel, and the ways in which decisions are made. The board plays a key role in risk management and the organisational culture by influencing senior-level reward systems, accountabilities, and performance evaluations. The board also sets "the tone at the top" through governance and reporting protocols, ethical and behavioural expectations, and approval of resources for strengthening risk management capabilities, and in its interactions with management, shareholders, and the public.

Putting the Framework to Use

Boards have used the framework presented here (and other frameworks) not only to define and organise their governance responsibilities, but also to improve them. The framework's versatility allows companies to adapt it to a variety of situations, ranging from new director transitions to preparing for an initial public offering of stock to conducting annual board evaluations, as discussed below:

- ***Transitioning new directors***: The framework provides a structure that assists a newly appointed director or chairperson in making an effective, efficient transition. It can help an incoming chairman to consider the board's activities and to develop a plan to identify and address any challenges. The framework also creates a methodical yet dynamic context for structuring discussions around the organisation's level of proficiency in each area of governance.
- ***Preparing for an initial public stock offering***: Corporate governance has become a key component in preparations for going public in many countries and on certain securities exchanges. In readying a company to go public, management, the board, and advisors have utilised the framework to designate a desired "future state", with key areas of governance to be addressed in the months leading up to the stock offering. The framework helps the board to position the company for long-term excellence as well as for the initial public offering.
- ***Assessing board performance***: When performed effectively, board assessments are a strategic activity for the company, holding long-term benefits for the board and senior executives. The framework provides an overall structure for designing an assessment that identifies areas of governance that warrant attention and activities that may provide opportunities for improvement.

In addition, a good number of the issues identified and discussed in the pages to follow in this guide can be "mapped" to the Deloitte framework and categorised as responsibilities of the board, of management, or in some cases both.

Figure 2. Mapping Responsibilities to the Framework

Issues identified in:	Would potentially fit within:
Setting the scene – entities/sources/governance issues, developments, trends, and challenges	• Governance, within the board's responsibilities
Shareholders	• Governance, within the board's responsibilities • Reporting/Compliance, within management's responsibilities
Management body and management	• Talent, within the board's responsibilities • Performance, within management's responsibilities
Transparency and reporting	• Performance, within the board's responsibilities • Reporting, within management's responsibilities
Corporate social responsibility	• Strategy/Governance, within the board's responsibilities • Planning/Operations/Reporting/Compliance, within management's responsibilities

Most issues and activities related to legal structure, regulatory compliance, and shareholder rights and responsibilities would relate to the board governance element and to management's reporting and compliance elements. However, issues covered in the pages to follow in this guide also affect culture, as well as performance, strategy, and talent (among board responsibilities) and planning and operations (among management responsibilities).

Improving Corporate Governance

Among other applications, Deloitte developed its Global Governance Framework to provide companies with a tool for pinpointing areas of their governance programmes that may need attention and to assist in assessing effectiveness in specific areas. In this context four attributes are necessary for effective board oversight of performance, strategy, governance, talent, integrity, and risk:

- ***Skills and knowledge***: Do the skills and experiences of the board align with the strategy of the organisation, now and into the future? Do board members – individually and collectively – have the right knowledge to provide effective oversight?
- ***Process***: Do board policies and activities align with marketplace practices and stakeholder expectations? Are board practices focused on the organisation's strategic priorities, optimising limited time and resources?
- ***Information***: Is the right information delivered to the board in the right format and at the right time? Does the board appropriately supplement the information received from management with insights from external sources?
- ***Behaviour***: Does the board fully execute oversight processes, draw on skills and experiences, and utilise information provided to it? Do directors come to meetings prepared and informed? Do they actively engage? Does the board effectively mentor and support the CEO and other executive management?

These broad questions can ignite the process of identifying gaps and opportunities in board performance and assessing effectiveness with regard to each area of governance. Once questions like these have been addressed, the board can more deeply analyse specific needs within the each area and ways of addressing them. For example, a board may determine that the quality and timeliness of information provided by management on performance is good, but that information on strategic planning is inadequate. Such distinctions help directors to translate concepts of board effectiveness into action.

Given heightened regulatory expectations and public scrutiny, organisations are seeking a holistic framework that boards can employ when creating and assessing processes and activities. The framework outlined here articulates areas of board governance, points to ways in which the board's oversight role aligns with management's role, and provides a context for developing a common understanding of roles and responsibilities.

We offer the Deloitte Global Governance Framework as a tool for developing a more integrated view of the organisation's governance needs and more effective ways of meeting them. We invite you to tailor the framework to the needs of your board and company, and to use it at the board and management levels – and jointly between the two bodies – to develop strong, sustainable governance structures and practices.

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Robert J. Kueppers

Deloitte LLP
30 Rockefeller Plaza
New York, NY 10112-0015
USA

Tel: +1 212 492 4241
Fax: +1 212 653 5620
Email: rkueppers@deloitte.com
URL: www.deloitte.com

Robert J. Kueppers is Managing Partner, Center for Corporate Governance and Senior Partner, Global Regulatory and Public Policy for Deloitte LLP. During Mr. Kueppers' 36 years of professional experience, he has served in a variety of senior leadership roles, including Deputy Chief Executive Officer of Deloitte LLP where he was responsible for regulatory and professional matters in the United States.
Mr. Kueppers is active in issues affecting the auditing profession, and is a frequent speaker and writer on these topics. In 2009 and 2012, he was recognised by *NACD Directorship* magazine as one of the top 100 influential professionals in corporate governance and in the boardroom. Mr. Kueppers is chairman of the board of directors of United Way of New York City, chairman of the University of Minnesota's Carlson School of Management Board of Overseers, a board member of American Corporate Partners, a founding trustee and president of the SEC Historical Society, and a trustee and executive committee member of the Committee for Economic Development.

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GLG
Global Legal Group

59 Tanner Street, London SE1 3PL, United Kingdom
Tel: +44 20 7367 0720 / Fax: +44 20 7407 5255
Email: sales@glgroup.co.uk

www.iclg.co.uk