

Codes of Corporate Governance

A Review

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MILLSTEIN CENTER WORKING PAPERS

The Millstein Center for Corporate Governance and Performance at the Yale School of Management has a mission of serving as a vital contributor to the growing architecture of international corporate governance. The Center sponsors academic research, hosts conferences and roundtables, generates databases, tests policy ideas, and publishes working papers by scholars and practitioners to expand knowledge and stimulate discussion on emerging corporate governance issues.

This working paper is authored by Nolan Haskovec, manager, Deloitte LLP, and visiting research fellow for corporate governance at the Millstein Center. It includes research written by Dr. Andrew Clearfield, principal of Investment Initiatives and former global corporate governance executive at TIAA-CREF. The paper does not reflect the positions of the Millstein Center, Yale School of Management, Yale University, or any of the Code and Standards Program (the “Codes project” or the “project”) sponsors.

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FOREWORD BY IRA MILLSTEIN

The Millstein Center's Codes and Standards Program was founded after Lisa Tepper Bates, then a student in one of my corporate governance classes, wrote a final paper proposing a code for the U.S. Her argument was that authoritative national guidelines, if well framed, would be superior to rigid law and would encourage long term behavior. Indeed, codes of corporate governance around the world are intended to provide guidance at the frontier where law ends and market practice begins. Where they exist, principles can encourage corporate boards and shareholders to better understand common interests and better define expectations of each other. The question was whether a national code was wise, feasible, or desirable for the U.S.

To address the issue, the Center—with guidance from a balanced steering committee—undertook research to better understand how and under what circumstances codes have worked or failed to improve performance or reduce risk, particularly in Europe. In the course of roundtables and academic inquiry, it was learned that not all codes achieve their objectives. But many do—and there is strong support for them from among corporate directors, executives, and shareholders. The reasons parties cite are important for the U.S. to study. Corporate governance codes appear to help boards, managers, and investors identify their respective responsibilities. They give those with ‘skin in the game’ more of a voice in framing practices than intermediaries. They can build grounds for long term behavior. They can help strengthen board oversight. They can illuminate ways for directors and boards to communicate. And codes can help minimize the intrusion of law and regulation into market practice.

One strength of codes over law is that they can more easily adapt over time to changes in the market. Moreover, stewardship codes emerging alongside governance codes aim to foster responsible and constructive investor behavior, something boards need in order to build long term value.

Despite the apparent advantages codes have brought markets, the Codes and Standards Program also uncovered downsides and pitfalls. Some codes have failed for lack of endorsement by key parties, or for lack of leadership. Some have featured principles that have become as rigid and prescriptive as law. Some stray into micro management.

Part of the advantage of the U.S. coming late to the exercise, though, is being able to learn from the experience of others. Findings in this working paper contribute to greater

understanding of what codes are and are not. Whether the U.S. should develop a code remains an open question, but one that can now move to more informed debate. Participants in the March 2012 New York roundtable agreed that there are now grounds to take that next exploratory step.

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I. BACKGROUND

The United States has had an unusual feature in an increasingly important area of corporate governance: it is almost alone among significant markets in having no single, authoritative national code of corporate governance serving as a generally-accepted benchmark of practices. To explore this phenomenon, the Millstein Center for Corporate Governance at the Yale School of Management founded the Governance Codes and Standards Program. It aims to encourage research into, and disseminate further knowledge of, international experience in the field of corporate governance codes and standards.

The first phase of the project, which is sponsored by the Millstein Center, Deloitte, PGGM, TIAA-CREF, Prudential Financial, and Microsoft, consists of (1) a call for papers by scholars on the general topic of governance standards; (2) two roundtables of both practitioners and academics focused on experience with codes; and (3) publication of one or more authored working papers on the topic.

The call for papers was issued in July 2011; out of the submissions, four academic papers were blindly selected by the scientific committee. The papers have been finalized and submitted to the Millstein Center.

The first roundtable was convened on October 13, 2011, in Zeist, the Netherlands at the headquarters of PGGM. The meeting brought together a select group of thought-leader European Union (EU) corporate directors, investors, regulators, code authors, and other experts to identify lessons to be learned from the European experience so far. Specific topics of discussion at the first roundtable included the impact of corporate governance codes on company performance; investor attitudes toward codes of corporate governance; and the role of codes of corporate governance in markets.

The second roundtable was held on March 29, 2012, in New York City. Topics for discussion at the second roundtable included lessons learned from Europe; corporate board and investor relationships with codes of corporate governance; and whether paths might, or should, be found for developing a code of corporate governance in the U.S. The roundtable was attended by influential representatives of investing institutions and public corporations.

This working paper is organized into five main sections – (1) setting the stage for codes of corporate governance; (2) examining codes of corporate governance from an international perspective, including their history; (3) focusing on lessons learned from the first roundtable for the Codes and Standards Program held in Europe; (4) background on codes of corporate governance in the U.S.; and (5) Code project next steps.

II. INTRODUCTION

The U.S. was one of the first nations in the world to concern itself with the governance of its publicly-listed corporations. But it stopped well short of developing authoritative general standards of corporate governance. By contrast, many of the world's other markets have by now agreed to some sort of 'official' principles for the governance of their quoted companies.¹

A key reason often cited for why the U.S. lacks a single, authoritative national code of corporate governance² is the general resistance to centralized regulation of corporate law, which is subject to state rather than federal statutes. But several other major countries have federal systems which distribute the burden of regulation, and many more have markets subject to more than one regulator. In any case, governance codes are as much about cooperation as they are about regulation, and the nearly universal adoption of the 'comply or explain' approach throughout Europe has left enforcement largely up to market forces.

Another possible reason is that the U.S. has a history of rules-based regulation rather than a principles-based consensus. This tradition may give rise to concerns that a code could become an overlay of rules rather than broad guidelines allowing interpretation.

Or, it could be that a need for a code of corporate governance has not been demonstrated in the U.S., or because the process of evolving from a multiplicity of individual sets of governance standards may be seen as preferable to the formal practice of charging a specific group with the task of devising a single code that will transcend all others.

Irrespective of the reason for not having a single, authoritative code of corporate governance, there appear to be various unintended consequences flowing from its absence. Some believe that without a code of corporate governance, the job

of corporate governance standard-setting for the market as a whole has, in effect, defaulted to proxy advisory firms. These commercial intermediaries choose (sometimes in consultation with client investors) which governance standards are, in their opinion, best, evaluate corporations against those guidelines, and then recommend to institutional investors how to cast share votes to advance those standards. By contrast, in markets where authoritative national codes exist, proxy advisors tend to defer to or adapt these generally accepted principles in making voting recommendations.

Such outcomes have spurred the question of whether the time has come for private sector parties in the U.S. to consider bringing a national governance standard into being. This paper addresses the topic; first, by examining what codes of corporate governance are, including where they originated, their purpose, to whom they are aimed, and under what conditions they achieve objectives. Next, the paper looks at codes from an international comparative and historical perspective. Then, it reviews lessons learned from codes of corporate governance in Europe, before turning to the U.S. experience with codes of corporate governance and next steps.

¹ European Corporate Governance Institute (ECGI), "Index of All Codes." Available at: www.ecgi.org/codes/all_codes.php.

² It is acknowledged within Section VI. *Corporate governance codes in the U.S.*, that the U.S. does have several decentralized codes of corporate governance under the ownership and authorship of many organizations.

III. SETTING THE STAGE: WHAT IS A CODE?

Codes of corporate governance have existed for more than two decades and have been developed in many jurisdictions worldwide. The commonly used definition is straightforward: “codes of corporate governance are defined as a set of ‘best practice’ recommendations with regard to the behavior and structure of the board of directors of a firm.”³ In recent years, some codes have gone beyond those boundaries to embrace the governance characteristics and behavior of institutional investors and intermediaries as well, via stewardship codes. To gain a fuller picture of their rise, use, and effectiveness in capital markets, codes are analyzed below using a series of clarifying questions.

A. WHERE DID CODES ORIGINATE?

Codes of corporate governance have developed for many reasons and in response to different circumstances, some specific to countries and, at other times, specific to events. Scholars Aguilera and Cuervo-Cazurra⁴ note the creation of a code in Hong Kong in 1989 and another in Ireland in 1991. The first widely recognized national code of corporate governance was released in the United Kingdom in 1992 under the leadership of Sir Adrian Cadbury. It was titled “The Financial Aspects of Corporate Governance” (the “Cadbury Code”). Following serial revisions under different chairs, the code is now administered by the Financial Reporting Council (FRC) under the name “The UK Corporate Governance Code.”⁵ The first influential international code was produced by the Organisation for Economic Co-operation and Development (OECD) in 1999 following recommendations of a business advisory committee led by Ira Millstein.⁶

Today, corporate governance codes may be found in almost 90 markets around the world. A full, regularly-updated online inventory of such codes may be found at the website of the European Corporate Governance Institute (ECGI): http://www.ecgi.org/codes/all_codes.php.

³ Ruth V. Aguilera, Alvaro Cuervo-Cazurra, and Soyoung Kim, “Taking Stock of Research on Codes of Good Governance,” September 15, 2008.

⁴ Ruth V. Aguilera and Alvaro Cuervo-Cazurra, “Codes of Good Governance,” *Corporate Governance: An International Review*, May 2009.

⁵ Financial Reporting Council (FRC), “The UK Corporate Governance Code” (often referred to by its former name, “The Combined Code”). Available at: www.frc.org.uk/CORPORATE/ukcgcde.cfm.

⁶ Organisation for Economic Co-operation and Development (OECD), “OECD Principles of Corporate Governance.” Available at: www.oecd.org.

The focus on codes came in the wake of economic stagnation in the 1970s and the rise of corporate raiders in the U.S. in the 1980s. Progress in code development stemmed from interest among four major parties: stock exchanges, government, companies, and institutional investors.

Stock exchanges pressed for governance codes to enhance the reputation of their markets and member companies as a means of attracting capital. Government, for its part, was concerned with finding ways to strengthen domestic companies against the threat of failure or takeover. Codes of corporate governance were appealing because they did not trigger the political resistance that would have come from statutory and regulatory intervention.

Corporate board members became increasingly interested in governance practices and how companies should be run. In Britain, with dispersed share ownership, a wave of privatized companies, and several high-profile scandals, some nonexecutive directors became concerned about management over-reach. In the absence of guidance regarding the roles of boards, directors had often not felt empowered to do anything beyond ratifying whatever executives put in front of them. In other markets, where companies were growing increasingly dependent on equity capital provided from all parts of the world, boardrooms backed codes as a way of sending positive signals to investors.

Institutional investors supported codes, too, often out of uncertainty about how and when to exercise rights at companies, and because of concerns over a lack of access to boards presiding over under-performing firms.

While many factors leading to codes differed from country to country, there were also similarities. Usually, the process began with dissatisfaction with the existing corporate governance regime within at least one of the major ‘constituencies’ involved in capital markets (issuers, financial intermediaries, regulators, the accounting profession, the bar, institutional investors, and the investing public.) Often, there were scandals igniting interest. The Cadbury Code, for instance, gained traction from pension and governance failures that were exposed in the 1990s. Another common driver was concern that capital was being diverted to other markets because of perceived deficiencies in the governance regime.

Typically, an authoritative intermediary – either the stock exchange or government – herded issuers together, sometimes with, and sometimes without, investors and other market parties, to craft a national code. Often, the government sought to encourage the process by threatening legislation if appropriate voluntary standards were not agreed upon. In some cases, existing regulations were expanded upon within codes of corporate governance. In other cases, governance standards for the country (or other jurisdictional entity) were created anew. Once a code had been written, governments usually moved quickly to endorse it and encourage or require its application to all listed corporations. Sometimes, a few code provisions migrated into law; more often, the purpose of the code was to provide a flexible extension of regulation into areas where it was felt that rules might be too restrictive.

B. WHAT IS THE PURPOSE OF A CODE?

Generally, originators of codes of corporate governance did not intend them to be some kind of gentler version of one-size-fits-all, rigid, and binding regulation. Rather, they conceived of a code as an over-arching, flexible, and principles-based framework that provides for companies adopting guidelines to either comply with provisions, or to explain why they are not in compliance. This is often described as a ‘soft standards’ approach based on a ‘comply or explain’ regime rather than hard rules policed by law and regulation. In most instances, codes are developed to be flexible enough to encompass the views of many actors within a single market: multiple company types, many industries, and many stakeholder groups. Codes aim to help guide the actions of the board or other market participants, and to provide benchmarks that can be used by others to evaluate their performance in light of those standards.

It is important to emphasize that governance codes are expressed as principles subject to exception, rather than as regulation subject to penalty, because authors typically wish to accommodate the fact that individual situations and circumstances may vary, and codes can help to provide flexibility. Codes are meant to begin where law stops. Although it is possible that in some instances, codes of corporate governance may morph into regulation or rules, codes of corporate governance have generally been intended to be flexible and principles-based.

C. TO WHICH PARTIES ARE CODES AIMED?

Earliest codes were aimed squarely, and almost exclusively, at corporations. More recently, governance codes have been developed to address the behavior of other market actors, such as institutional investors and intermediaries via stewardship codes.

I. CODES FOR COMPANIES

Company oversight boards operate by means of a flotilla of formal governance documents including the articles of incorporation, by-laws, corporate governance guidelines, committee charters, and codes of conduct. Codes of corporate governance are meant to provide flexible standards and best practices for companies to consider alongside this governance framework. Although each company varies in the practices, policies, and procedures that make up its framework (given unique businesses and industries), there are certain commonalities that are overarching amongst all companies. Codes of corporate governance often serve as a tool to outline the structure and behavior of the board, including how it interacts with management. Codes may serve to either supplement or go beyond any minimum governance regulations to which the company may already be subject. As an example, law may allow a corporation’s directors to opt for any form of board leadership they prefer. A code may suggest considerations directors should take into account when making their choice.

II. CODES FOR INVESTORS

Best practice standards addressing investors were a small part of early corporate governance codes, such as Cadbury and the OECD. Normally, text focused not on the institution’s own governance, but on the shareowner’s responsibility to support adherence to the corporate code by portfolio companies. More recently, the rise of ‘stewardship’ codes in different jurisdictions has expanded into detailed guidance on such investor responsibilities. Further, some codes touch on the governance characteristics of the investor itself. The first such effort was produced by the International Corporate Governance Network (ICGN) as a multinational guide.⁷

⁷ International Corporate Governance Network, “ICGN Global Corporate Governance Principles: Revised (2009).” Available at: http://www.icgn.org/files/icgn_main/pdfs/best_practice/global_principles/icgn_global_corporate_governance_principles-_revised_2009.pdf.

The most prominent national example is the UK's Stewardship Code.⁸ A U.S. example is the 2007 Clapman Report, produced at Stanford Law School.⁹

D. WHO WRITES CODES?

Codes seen as authoritative are written by a variety of corporate governance stakeholders. A model of multi-stakeholder authorship is the UK's Cadbury Committee, which consisted of a cross-section of prominent individuals in markets, including those associated with companies, investors, accounting firms, regulators, banks, corporate governance interest organizations, academics, and stock exchanges, among others. Each of these individuals (and the companies or organizations they represented) provided a unique perspective on corporate governance. They also helped to determine additional corporate governance considerations that would be above and beyond current legal or legislative requirements. Cadbury demonstrated that code drafting can represent a bargaining process, whereby each group brings a "wish-list" to the table, and then the recommended provisions of each of the constituents are negotiated.

Codes can also be developed not in a multi-stakeholder context but by single interests within a market. France is a prime example. The nation's original Viénot Code, updated and now linked to the Mouvement des Entreprises de France (MEDEF) employers association, was the product of a group composed of corporate interests, with no shareowner participation. In reaction, the Association Française de la Gestion Financière (AFG) in France, representing asset managers, wrote its own code of corporate governance. The rival codes coexist. But a single-stakeholder code, of course, runs the risk of being more limited than if it incorporated the views of a large cross-section of corporate governance stakeholders.

Codes may also be sponsored by bourses. Canada's 1994 "Where Were the Directors?" report,¹⁰ setting out widely-adopted best practices for corporate boards, was commissioned by the Toronto Stock Exchange.

Finally, public authorities can author codes. In the European Union, markets such as Germany and the Netherlands have officially-sanctioned commissions responsible for writing and revising governance codes. Elsewhere, Brazil's Comissão de Valores Mobiliários (CVM – or Securities and Exchange Commission) developed the nation's first code in 2002, and China's Securities Commission did the same for that market in 2001.

Writers of newer codes have an advantage compared to their antecedents: they can build on and adapt experience gained from earlier codes. In addition, the drafting process for new codes of corporate governance may involve use of the OECD guidelines, as well as those of global bodies such as ICGN, which issued corporate governance principles.

Subsequent to their original publication, codes of corporate governance are often periodically updated, either by the original author(s) or by others charged with expanding either the scope of the code or the parties to which it may be applicable. Any change in an authoritative code will likely alter the national governance dialogue almost immediately. Therefore, in the run-up to an anticipated reconsideration of the code, a broadly-based debate upon the need for specific changes (including loosening, as well as tightening of certain standards) is likely to develop.

E. WHAT CONTENT IS TYPICALLY INCLUDED IN CODES OF CORPORATE GOVERNANCE?

The content and provisions included in each code of corporate governance is likely to vary based on the jurisdiction and on the objectives of the individuals and groups who contributed to its development. However, some common elements may be identified. Writing in *Accountancy Ireland*, author N. O'Shea¹¹ identified six governance practices that were either directly or indirectly discussed in most national codes of corporate

⁸ Financial Reporting Council (FRC), "The UK Stewardship Code" (July 2010). Available at: <http://www.frc.org.uk/images/uploaded/documents/UK%20Stewardship%20Code%20July%2020103.pdf>. Information on the consultation for changes for "The UK Stewardship Code" available at: <http://www.frc.org.uk/corporate/investorgovernance.cfm>.

⁹ Stanford Institutional Investors' Forum at Stanford Law School, "The Clapman Report" (June 2007). Available at: <http://www.law.stanford.edu/news/pr/65/Stanford%20Governance%20Experts%20Seek%20Investment%20Fund%20Reform/>.

¹⁰ European Corporate Governance Institute (ECGI), "Where Were the Directors?". Summary available at: www.ecgi.org/codes/documents/dey.pdf.

¹¹ N. O'Shea, "Governance how we've got where we are and what's next," *Accountancy Ireland*, 2005.

governance. The six governance practices identified by O’Shea, along with summarized category titles, are as follows:

1. Board composition: a balance of executive and nonexecutive directors, such as independent, nonexecutive directors;
2. Board leadership: a clear division of responsibilities between the chairman and the chief executive officer;
3. Information: the need for timely and quality information provided to the board;
4. Nominations: formal and transparent procedures for the appointment of new directors;
5. Reporting: balanced and understandable financial reporting; and
6. Risk: maintenance of a sound system of internal control.¹²

Guidance at an international level may be even broader so as to be relevant to widely divergent legal, governance, and cultural environments. The OECD Principles, for instance, addressed five general categories:

1. the rights of shareholders and key ownership functions;
2. the equitable treatment of shareholders;
3. the role of stakeholders in corporate governance;
4. disclosure and transparency; and
5. the responsibilities of the board.¹³

In some instances, stewardship codes, which help to set out behavior expectations for investors with regard to corporate governance, have also been developed to complement a code of corporate governance. Some have argued that codes of corporate governance, on their own, absent a stewardship

component, may not be enough; thus, some countries have worked to formalize institutional investor behaviors and expectations. A popular example of a stewardship code includes “The UK Stewardship Code” from the FRC, which is currently undergoing a consultation for changes.¹⁴ “The UK Stewardship Code” is based on seven key principles, stating that “institutional investors should:

1. publicly disclose their policy on how they will discharge their stewardship responsibilities.
2. have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed.
3. monitor their investee companies.
4. establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value.
5. be willing to act collectively with other investors where appropriate.
6. have a clear policy on voting and disclosure of voting activity.
7. report periodically on their stewardship and voting activities.”¹⁵

F. WHO USES CODES

Corporations are one of the main ‘users’ of a code. Executives may utilize them to address compliance, benchmark the company against peers, test governance risks, and communicate a profile to stakeholders. Board directors can use them to develop effective practices. Of course, the types of company

¹⁴ Financial Reporting Council (FRC), “The UK Stewardship Code” (July 2010). Available at: <http://www.frc.org.uk/images/uploaded/documents/UK%20Stewardship%20Code%20July%2020103.pdf>. Information on the consultation for changes for “The UK Stewardship Code” available at: <http://www.frc.org.uk/corporate/investorgovernance.cfm>.

¹⁵ Financial Reporting Council (FRC), “The UK Stewardship Code” (July 2010). Available at: <http://www.frc.org.uk/images/uploaded/documents/UK%20Stewardship%20Code%20July%2020103.pdf>. Information on the consultation for changes for “The UK Stewardship Code” available at: <http://www.frc.org.uk/corporate/investorgovernance.cfm>.

¹² N. O’Shea, “Governance how we’ve got where we are and what’s next,” *Accountancy Ireland*, 2005.

¹³ Organisation for Economic Co-operation and Development (OECD), “OECD Principles of Corporate Governance.” Available at: www.oecd.org.

users can vary depending on the code. For example, some codes may be applicable to a specific type of company, such as those issuing public equity. In other instances, public, private, not-for-profit, state-owned, or some mixture of these enterprises may be subject to a code.

Investors such as financial intermediaries, institutional investors, or retail shareowners are also users of codes. They rely on them to assess a portfolio company's governance risk and responsiveness to shareowners in the context of trading decisions and/or to help guide voting and engagement. Investors use stewardship codes to inform their own behavior as equity owners, and to address relationships with other stakeholders, such as beneficiaries.

Public policy officials and regulators are also users of codes of corporate governance. Regulators rely on them to identify trends in governance practices and standards; policymakers use them to help achieve certain objectives – such as curbing politically unpopular excessive CEO pay, or attracting investment – without undergoing a process of enacting legislation. Stock exchanges, too, may find codes advantageous. They may promote guidelines to enhance the market's brand identity and attract members and capital.

Other stakeholders may be thought of as users of codes. These include the accounting profession, the bar, civil society organizations, and beneficiaries.

G. WHO MONITORS ADHERENCE AND WHAT HAPPENS IF A COMPANY DOES NOT FOLLOW RECOMMENDATIONS?

The question as to what happens if a company does not follow an adopted recommendation hinges largely on (1) the manner in which the board handles such a deviation; (2) who is responsible for monitoring adherence; and (3) the type of code which is being referenced – whether a principles-based ‘comply or explain’ code, or a more rules-based, regulatory code.

Companies that choose not to follow a recommendation but provide a robust explanation for such divergence are generally considered by the market to have complied with the code. It is then up to stakeholders such as investors to determine whether the explanation is persuasive. Their judgment may affect the way they vote, engage, or buy and sell the company's shares. Companies that fail to supply an explanation, or that offer little by way of justification for a deviation,

may be considered to have failed to comply with the code. In practice, market participants observe that, on occasion, media, proxy advisors, and institutional investors will consider a company as having failed compliance if it deviates, even with a thorough explanation.

The task of evaluating whether a company has complied is normally left to market bodies, and sometimes stock exchanges, rather than regulators. Investors may undertake such evaluations in house, but often rely on collective bodies (Eumedion in the Netherlands, for instance), governance rating firms, or proxy advisors to provide such analysis.

H. WHAT ARE THE POTENTIAL BENEFITS OF A CODE?

Corporate governance codes are often framed as relatively flexible guidelines to best practice rather than as a set of rigid rules that must be complied with upon pain of sanction. Codes – especially those that result from multi-stakeholder efforts – can express a joint consensus on best approaches within a market without binding companies or investors too narrowly or in ways that restrict innovation and enterprise-specific needs. Codes may serve in some instances as alternatives to law or regulation.

National governance codes may be used by proxy advisors as a benchmark in making recommendations to client investors regarding voting. In the absence of a code, proxy advisors may be more likely to apply standards of their own construction. These may or may not take account of the perspectives of corporations and investors.

Governance codes may also be used as an underpinning for direct engagements between investors and their portfolio companies. An accepted benchmark of governance can be a starting point for such discussions. Without a code, parties must instead assess whether the company's behavior is in strict compliance with the law, or whether it is aligned with subjective preferences expressed by a single market actor.

Additionally, stewardship codes developed through multi-stakeholder discussions can set consensus minimum expectations on investor behavior as asset owners.

I. WHAT ARE THE POTENTIAL DOWNSIDES OF A CODE?

Principles are difficult to negotiate in a multi-stakeholder exercise. Any outcome inevitably represents a compromise between major parties, some of whom feature competing

IV. CODES AROUND THE WORLD

interests and perspectives. There is potential that any final code could draw criticism for being either too lax or too prescriptive on various topics. More likely, observers could attack the result as being so general in nature that it represents only a marginal improvement over no codes, and at the cost of a high expenditure of effort.

Although codes may be more flexible than law, they can still be challenging to adapt as markets change. Nations with ongoing bodies responsible for the code's integrity (e.g. the UK's Financial Reporting Council; Germany's Kodex Commission) have an easier time periodically considering revision. They have an infrastructure and a consultative process in place. Those without such structures must address the task of identifying and convening a process to update the code. The more difficult it is to adapt a code, the greater the risk that it diverges from changing practice and loses impact and legitimacy over time.

Codes born of a single stakeholder group are naturally easier to construct, as interests may generally converge; but they are less likely to gain traction as an authoritative national code. Similarly, codes that address corporate governance without also focusing on investor responsibilities and stewardship may fail to reach full potential.

Codes may be applied in practice in ways that undermine their value as flexible instruments for encouraging value creation and accountability without rigid rules. For instance, corporations may consider recommendations as compliance exercises, anxious that investors, the media, and other stakeholders will reward simple adherence rather than consider explanations regarding customary practices. For their part, institutional investors and their agents may indeed fall into the practice of judging companies against compliance rather than explanations.

As of 2012, there are almost 90 countries with codes of corporate governance, with many countries having multiple codes, according to the online index of codes available through the European Corporate Governance Institute (ECGI).¹⁶ Each code came into being through a different process. A brief tour of codes can help show how they have become embedded in the architecture of significant markets. The state of corporate governance guidelines in the U.S. is explored further within *Section VII. Corporate governance codes in the U.S.*

A. THE UK

The best known of the pioneer corporate governance codes, one that set the pattern for many subsequent efforts, was produced by the commission chaired by Sir Adrian Cadbury in the UK. The Cadbury Committee issued its report in 1992 in the wake of various corporate scandals and widespread dissatisfaction with lax governance and abuse of auditing and reporting standards that allegedly had made these scandals possible. Impetus to create a committee came from the Bank of England (the "Bank"), which encouraged participation by the then-new Financial Reporting Council and the London Stock Exchange.

Sir Adrian assembled a panel consisting of representatives of many of the major players in the governance debate: executives, stock exchange officials, the UK government's Department of Trade and Industry, the accounting profession and, of course, the Bank. Armed with members' personal prestige as well as their positions of authority, the Committee issued a report recommending sweeping changes in the way British public companies were being run.¹⁷ The British government quickly endorsed the recommendations, which were then incorporated into the UK Listing Rules. Successor reports under different chairs refined the original document, and the UK Financial Reporting Council took over formal responsibility for administering what is now officially "The UK Corporate Governance Code."¹⁸

¹⁶ European Corporate Governance Institute (ECGI), "Index of All Codes." Available at: www.ecgi.org/codes/all_codes.php.

¹⁷ European Corporate Governance Institute (ECGI), "Report of the Committee on the Financial Aspects of Corporate Governance." Available at: www.ecgi.org/codes/documents/cadbury.pdf.

¹⁸ Financial Reporting Council (FRC), "The UK Corporate Governance Code" (often referred to by its former name, "The Combined Code"). Available at: www.frc.org.uk/CORPORATE/ukcgcde.cfm.

In addition to “The UK Corporate Governance Code,” as previously discussed, the UK Financial Reporting Council also issued a stewardship code in July 2010. “The UK Stewardship Code,” which is based on seven key principles for institutional investors, “aims to enhance the quality of engagement between institutional investors and companies to help improve long term returns to shareholders and the efficient exercise of governance responsibilities by setting out good practice on engagement with investee companies to which the [Financial Reporting Council] FRC believes institutional investors should aspire.”¹⁹

The UK codes are not firm regulations, but a roster of principles-based guidelines, compliance with which is voluntary. If a company or institutional investor chooses not to follow one, it must state why. The codes are seen as complementary to British company and market regulation, rather than as an extension of it. The intent among UK institutions is to ensure that the flexibility of the ‘comply or explain’ concept not be lost through positive law.

B. THE NETHERLANDS

Code development in the Netherlands was, at first, less collaborative than in the UK. Initially, there was a confrontation between the brokerage and investing communities on the one hand, and corporate managements on the other. Investors were intent on reducing the so-called Dutch discount, by which the value of domestic shares were pegged lower, owing to formidable entrenchment devices. Dutch corporations, for their part, were fearful of European Commission efforts to lower anti-takeover barriers in an environment where unsolicited bids were becoming more common. They joined with the Amsterdam Stock Exchange to create a committee under the chairmanship of Jaap Peters, former chief executive of Dutch insurer Aegon. The committee’s objective was not to write a comprehensive code but, rather, to review Dutch corporate governance and make proposals to improve it. The Peters Report, with forty such recommendations, came out in 1997, and was the basis for a self-regulated system for the next six years.

¹⁹ Financial Reporting Council (FRC), “The UK Stewardship Code” (July 2010). Available at: <http://www.frc.org.uk/images/uploaded/documents/UK%20Stewardship%20Code%20July%202010.pdf>. Information on the consultation for changes for “The UK Stewardship Code” available at: <http://www.frc.org.uk/corporate/investorgovernance.cfm>.

Government concerns over the adequacy of the original report led to pressure to create the more comprehensive Tabaksblat Code of 2003. Representatives of the same interests, reinforced by a greater presence of investors, academicians, and lawyers, drafted the new code. This latter document, following the methodology of ‘comply or explain’²⁰ was subsequently given official status by the Dutch parliament: publicly quoted companies must either make good effort to apply the standards therein, or go on record justifying why they do not. Eumedion, the collective body of domestic and non-resident institutional investors, analyzes these Dutch company disclosures and reports regularly on their accuracy and compliance with the code.

Despite the important difference that the Netherlands has a civil as opposed to common law system, with compulsory two-tiered boards, the conclusions reached and recommendations made were similar to those of the Cadbury Commission and its successors.²¹ Through several iterations, the updated Tabaksblat Code has become a model for many other civil law countries that are developing codes.

Eumedion, the institutional shareholder group, published “Manual: Corporate Governance” setting out shareholder rights and responsibilities, as well as certain other practical matters.²² Additionally, in June of 2011, the Eumedion Corporate Governance Forum published a stewardship-code equivalent, “Best Practices for Engaged Share-Ownership,” which is a “series of best practices as guidance for its participants – which include pension funds and the asset managers of these pension funds – in fulfilling their essential role in the governance of listed companies.”²³

²⁰ The Dutch is “pas toe of leg uit,” better translated as ‘apply or explain,’ which is even less prescriptive.

²¹ One key difference was that several advisory provisions in “The UK Corporate Governance Code” – e.g., shareholder votes on the company’s remuneration policies – were made binding in the Netherlands.

²² Eumedion, “Manual: Corporate Governance” (2008). Available at: <http://www.eumedion.nl/en/public/knowledgenetwork/manual/2008-manual-corporate-governance.pdf>.

²³ Eumedion Corporate Governance Forum, “Best Practices for Engaged Share-Ownership Intended for Eumedion Participants” (June 30, 2011). Available at: http://www.eumedion.nl/en/public/knowledgenetwork/best-practices/best_practices-engaged-share-ownership.pdf.

C. FRANCE

In France, two major concerns drove appetites for a governance code: abuse of minority shareholders by controlling shareholders, and better definitions of the role and duties of government appointees in the many enterprises in which the French state was the dominant shareholder. In 1995, the combined associations of corporate issuers created a committee led by Marc Viénot, the président directeur général (PDG) of Société Générale, to draft a set of recommendations to improve corporate governance. It was composed entirely of CEOs, with no representatives of the investor community. That effort is now ‘owned’ by the MEDEF, France’s employers association.

The absence of investors on the Viénot Committee prompted domestic institutions, organized through the AFG fund managers association, to name its own commission charged with developing corporate governance guidelines. Jean-Pierre Hellebuyck, chief investment strategist at Axa, chaired this initiative. AFG continues to oversee and update its code; and it has also collaborated with Proxinvest, a Paris-based proxy advisor, to analyze French issuers in part by how they meet AFG guidelines.

While neither the recommendations of Viénot nor Hellebuyck (and successor panels) were formally sanctioned by the French government, the MEDEF code is often considered the de facto benchmark for French board governance.

D. GERMANY

In Germany, the national code, produced in 2002, was an initiative of the federal government, with support from market participants. The German Corporate Governance Code Commission, originally headed by Gerhard Cromme, then Chair of ThyssenKrupp, included both investors and academic members of the legal profession as well as company representatives and auditors. The Commission carries official government sanction for periodically updating the corporate governance code.

E. ITALY, SPAIN, SWITZERLAND

Italy, Spain, Switzerland, and other European countries have generally followed the Dutch model, with the leading national securities exchanges bringing together panels of prominent businessmen, experts, and a few leading investors, often under the aegis of, and with the implicit support of, their governments. All of the resulting codes were principles-driven, and all were rooted in the ‘comply or explain’ model.

F. EUROPEAN UNION

At the same time that national codes were coming into being throughout Europe, the European Union as a combined entity decided not to enter the field. Instead, the European Commission consistently pursued a strategy of encouraging the member states to create their own codes, hoping for some convergence further down the road, particularly with an emphasis upon the ‘comply or explain’ principle. It is expected to produce further guidance in this area in October 2012.

G. CANADA

Securities law in Canada, a common law jurisdiction, is even more federalized than it is in the U.S., although the Ontario Securities Commission is dominant because it has authority over the country’s largest securities exchange. The general approach has been to embed a voluntary code into the Toronto Stock Exchange’s listing standards, and to build outward from there to the various smaller companies quoted on regional exchanges.²⁴ Toronto began the process in 1994, naming Peter Dey to chair a multi-stakeholder group offering guidelines on a ‘comply or explain’ basis. More recently, many of the major investing institutions banded together in the Canadian Coalition for Good Governance to attempt to make sure that higher governance standards were properly implemented by quoted companies, and that institutions actively promoted those standards through their proxy voting and engagement with portfolio companies.²⁵

H. AUSTRALIA

In Australia, another common-law country with federalized regulation, a succession of scandals sparked a series of reports on governance from different sources, many of them academic and none having even quasi-official status. These paved the way for the Australian Stock Exchange (ASX) to create a committee with representation from multiple constituencies, including investing institutions.

²⁴ European Corporate Governance Institute (ECGI), “Where Were the Directors?”, Summary available at: www.ecgi.org/codes/documents/dey.pdf.

²⁵ Canadian Coalition for Good Governance (CCGG). Additional information available at: www.cccg.ca.

V. LESSONS FROM CORPORATE GOVERNANCE CODES IN EUROPE

This group, the ASX Corporate Governance Council, drafted, maintained, and promoted the Australian Corporate Governance Code, primarily through listing requirements and through the prestige of its recommendations.²⁶

I. SOUTH AFRICA

In 1993, the Institute of Directors established a committee with the additional sponsorship of the leading business organizations and named as chair Mervyn King, a businessman, lawyer, and former judge. The panel's charge was to study and make recommendations regarding South Africa's corporate governance. Its recommendations took the form of listing requirements on the Johannesburg Stock Exchange, although they were recommended for all corporations, public or private. Many provisions subsequently found their way into law, although the King Committee (as it is still called) has stated clearly through two follow-up revisions that it favors 'comply or explain' over hard-and-fast law.

Authoritative national corporate governance codes of one sort or another have been part of the market landscape outside the U.S. for more than two decades. But there is little research providing comprehensive analysis of their function, utility, and effectiveness. This research gap makes more challenging the task of drawing lessons relevant to revisions of existing codes or construction of fresh codes. For this reason, the Millstein Center included in its Codes and Standards Program inquiry (see Appendix A) a call for academic papers on codes (see Appendix B), as well as a roundtable of practitioners to discuss the impact of codes on various market constituencies in Europe. This section reviews findings from the roundtable.

The roundtable met in October 2011 at the offices of PGGM in Zeist, the Netherlands. Participants brought perspectives from the corporate, investor, intermediary, and public policy sectors, and from different member states in the European Union. The event also included representatives from four of the six project sponsors, including PGGM, TIAA-CREF, Deloitte, and the Millstein Center. Representatives from Microsoft and Prudential were not able to be present.

Discussion took place under the Chatham House rule, which permits use of any point raised so long as it is not attributed to any individual or institution.²⁷ The session was divided among three topics related to codes of corporate governance. Each was introduced by a discussant, after which the topic was opened for general discussion. What follows is a summary of main points raised in the sessions for each of the three topics and summarizes the discussions held among the participants, not the opinions of the author. Although this summary reflects the general discussion at the roundtable, it is acknowledged that not all participants shared the same views on each topic.

²⁶ Australian Securities Exchange (ASX), "Corporate Governance Council Principles and Recommendations." Available at: <http://www.asx.com.au/governance/corporate-governance.htm>.

²⁷ Chatham House rule is defined as follows: "When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed." Available at: <http://www.chathamhouse.org/about-us/chathamhouse-rule-translations>.

A. TOPIC 1: DO CORPORATIONS SEE CORPORATE GOVERNANCE CODES AS AFFECTING PERFORMANCE OVER THE SHORT, MEDIUM, OR LONG TERM, AND HOW DO THEY VIEW COSTS AND BENEFITS?

Discussion ranged over three subtopics: stakeholder interests in codes; the challenge of creating and implementing a code; and costs and benefits of a code. Although there appears to be little formal literature or research that definitively connects codes of corporate governance with performance of companies over any time horizon, the general opinion amongst many in the governance community is that codes of corporate governance can have a positive impact on company performance. It is recognized, however, that not all codes of corporate governance or companies are equal, and there are large differences in the views among stakeholders about codes.

I. STAKEHOLDER INTERESTS IN CODES

- Some suggested that codes may help to counterbalance flaws or shortcomings in the financial markets or in law and, if created well, they can help increase stability and market confidence. In the experience of many of the participants, codes helped improve checks and balances and transfers of power amongst investors and nonexecutive directors.
- Codes can bring more clarity to investor rights and, in some instances, investor responsibilities. Unlike regulation, codes permit flexibility and the involvement of investors. Codes depend crucially on the involvement of investors. Investors must be involved in writing codes, there must be expectations of investor behavior under codes, and investors must participate in monitoring corporate reactions to codes. One potential problem identified by roundtable participants was the perception that, although they have rights, shareowners do not often exercise these rights. Some investors are still absent, or guided solely by advisory firms, or they fail to integrate governance issues into asset management.
- Codes of corporate governance may increase the responsibilities of directors; codes may serve to inhibit the relationship between executives and nonexecutive directors by formalizing a framework that may empower directors to the detriment of executives.
- Participants emphasized that executives, to accept a code, needed to understand that there may be a transfer

of some powers to directors even if the end result is a gain in other areas. Executives are more likely to join in discussions to form a code to the extent they see it as in their interest and necessary because it can help the company with cost of capital, performance, investor loyalty, and reputation. In general, it was viewed widely amongst participants that executives have less of a problem enhancing the influence of long term or medium term investors, but that they may worry about handing the same rights to investors who have only short term interests.

II. CREATING AND IMPLEMENTING A CODE

- It can be challenging to determine where law ends and codes begin. Codes allow investors and boards to fill in where the law is (and often should be) silent. The first principle of a code is to establish the boundary between law and code. It was generally thought that codes need to focus on behavior more than structure, and to recognize that codes may have limited effects.
- The formulation of a code of corporate governance must be a collective and collaborative process; bringing together all parties in a market to create a code that is comprehensive in nature (taking into account the views of the various stakeholders) is critical.
- A strong association of directors may help, especially during the implementation process.
- It is important that a code gets buy-in from corporations, and that a few companies set examples for other companies to follow. In some countries where codes have been successfully implemented, observations were that at first, companies may not have wanted to adopt/comply, but did so because they did not want to be seen as an outlier trailing their peers. This has now changed to companies wanting to be seen as leading the pack. In some markets, such as France, corporations crafted a code primarily to avoid the government turning to law to force changes in corporate governance. Some participants noted that in Europe, companies that have been more open to codes have been those companies with nonexecutive chairs. Indeed, select participants noted that combined chair/CEO positions tend to represent an obstacle to the implementation of codes.

- To get off the ground and gain wide support, a code needs a leader as champion. In the Netherlands, for instance, Tabaksblat had to use his persuasive power and political capital to gain broad support for the Dutch code he authored. It is important to identify respected business leaders who can stand up and advocate for adoption of a code. Corporations need to feel that they have ownership in the outcome.
- Codes hinge on the existence of a strong monitoring body that reports in detail on corporate and investor compliance.
- Participants observed that companies too often assume they must comply rather than explain, and in a lot of cases, explanations tend to be boilerplate. It may well be that too many investors and proxy advisors prefer comply to explain, which leads companies to feel that compliance is the favorable response and that explanation could be a hindrance. Codes can be hijacked by parties who turn them into rules. Perhaps the formula should be amended to ‘comply and explain.’
- Participants found that codes are better instruments for affecting corporate governance change than law or regulation, which can lead to risk aversion by companies. Within the Netherlands, companies generally seemed to support the idea of setting up codes of corporate governance in order to avoid the formation of potentially harsh regulations. Portugal is a good case study where corporates there now fault themselves for failing to act ahead of regulation and law; the alternative may be worse – now companies have to satisfy regulators instead of investors.
- In the UK, Cadbury and successor codes achieved separation of chair and CEO, initiated ‘comply or explain,’ and allowed parties to innovate. In fact, the code proved stronger than regulation.
- Code success may be judged, in part, by whether it stimulates dialogue between funds and boards.

III. COSTS AND BENEFITS OF A CODE

- Costs and benefits of codes of corporate governance are not easy to measure. Directors may be spending more quality time on boards, but on the other hand, increased transparency has potentially been a catalyst for outcomes such as higher executive pay. As such, codes can have unintended consequences.

- Participants generally found that the quality of corporate governance affects a company’s cost of capital. It can also help lead to a better risk profile and lower risk premiums. As such, there is an incentive for corporations to want a code: they potentially get easier access to capital and it can help to strengthen long term relationships with investors.

IV. TOPIC 1: MAIN PARTICIPANT TAKEAWAYS

- Code development may often hinge on leadership by a respected champion.
- There needs to be collective buy-in from interested parties such as regulators, corporations, investors, intermediaries, and academics in order to make a code of corporate governance truly authoritative.
- The vitality of a code of corporate governance rests on the participation of investors both in the formulation of the code originally and on the monitoring component to see that covered parties are following and are in compliance.
- Codes are an important substitute for and, in some instances, a complement to, regulation.
- When campaigning for the adoption of a code of corporate governance, it is important to acknowledge that while executives and company management may transfer some powers or responsibilities, there are benefits for executives and company management that can be derived from a code of corporate governance.

B. TOPIC 2: HOW DO INVESTORS TAKE NATIONAL CORPORATE GOVERNANCE STANDARDS INTO ACCOUNT WHEN SHAPING THEIR BEHAVIOR IN RESPECT TO INVESTING, ENGAGEMENT, AND VOTING?

Discussion ranged over three subtopics: the role of investors at home and abroad; reliance on proxy advisory firms; and monitoring and collective action.

I. ROLE OF INVESTORS AT HOME AND ABROAD

- Participants generally found that codes of corporate governance have been highly influential and, as a result, investors have higher expectations of companies. Codes can sway how investors vote and engage with companies.
- A big challenge is how to get non-resident investing institutions involved and to apply governance standards similar to those based in the target market.
- For shareowners invested in another market, the local code is typically the starting point and the first step for understanding governance expectations. However, an institution will tend to apply its own standards based on its own concerns—say, on board competence, environmental and social risks, and international standards. Sometimes these standards are stricter than, or serve to contradict, codes in some markets. Although investors sometimes disagree with local codes, they generally go through local agents and apply local standards to investments outside their home markets.
- Conversely, some companies take issue with investors asking them to comply with codes and standards from different countries. Participants cautioned companies, though, to be careful what they wish for: having a single code embraced by all investors could result in a one-size-fits-all approach, which many participants at the roundtable cautioned against. It is necessary to understand that if the market is diverse, so also will there be diverse investor judgments.

II. RELIANCE ON PROXY ADVISORY FIRMS

- Investors say they need proxy advisors; without them, it would be difficult for fund investors to vote most stocks given the sheer volume of their portfolios. Most do not have the internal staff/research resources to cover every meeting, so reliance on outside advice is important.

- Codes tend to encourage corporate engagement with proxy advisors. Although the standards and policies of proxy advisory firms in applying codes of corporate governance can diverge amongst firms and countries, participants noted that the firms generally default to a local code when crafting recommendations on voting. As one example, Institutional Shareholder Services (ISS) surveys its clients' opinions on governance. Clients often, in turn, support application of the local code.

III. MONITORING AND COLLECTIVE ACTION

- Although proxy advisors play a useful role in informing investors about code expectations, it is also helpful to have a peer network of investors in other markets for discussion and collaboration.
- Monitoring corporate adherence to codes must be done on a collective basis by the market, and not by regulators. Nor can it be done best by proxy advisors, who are focused on voting items. Today, there is no common platform for monitoring code compliance at a global market level. However, this type of monitoring takes resources to do well. The Australian Council of Superannuation Investors (ACSI) may be a good example of a group organized to perform such monitoring efforts.

IV. TOPIC 2: MAIN PARTICIPANT TAKEAWAYS

- Codes of corporate governance may be a starting point to affect change in the world of corporate governance, but not an end. Investors tend to value local codes but also apply governance expectations rooted in their home markets.
- A key challenge is involving non-resident investors in applying codes.
- Investors play a critical role in not only helping to shape codes of corporate governance, but also in helping to monitor companies and boards for compliance. Investors generally value proxy advisors. However, investors have a difficult time monitoring all companies in their portfolios, so collective action amongst investors is critical. Accordingly, policy should be directed at practices for collective action.

C. TOPIC 3: DO THE WAYS IN WHICH CODES ARE FORMULATED AND IMPLEMENTED AFFECT OUTCOMES SUCH AS THE BEHAVIOR OF MARKET PARTICIPANTS? HOW?

Discussion centered around two subtopics: government involvement and accountability and enforcement.

In general, participants noted that there is great support for the ‘comply or explain’ framework in Europe.

I. GOVERNMENT INVOLVEMENT

- Participants observed that governments have often been critical to the birth of national codes in the EU. Even where they are not directly involved at the outset, they have helped in setting the regulatory framework for a code; for example, the requirement to ‘comply or explain.’ Such measures underpin a code. Although the government is necessary for a code to develop in certain markets, the danger in most countries comes in allowing government to be solely responsible for developing the content of a code. The distinction here rests between framework and content. It may be helpful to have the government’s involvement with the framework, but countries working to develop codes of corporate governance should be cautious that government not involve itself in content development.

- The threat of regulation has been an extremely important motivator in the development of codes. Companies may see a code as “legislation in the shadow of the law.” There is a paradox, however. Some believe that if something is put into a code, lawmakers will be more likely to see it as an invitation to embed the measure into law. Although it is possible that in some instances, codes of corporate governance may morph into regulation or rules, codes of corporate governance have generally been intended to be flexible and principles-based.

II. ACCOUNTABILITY AND ENFORCEMENT

- Debate exists about whether codes should be a ‘comply or explain’ framework or a ‘comply and explain’ framework. The fundamental question is to ask what should be included in the code of corporate governance and what should be included in the law. The challenge is drafting a code that is a balance between regulation and principle. There is a delicate balance between codes of corporate governance being too flexible and too prescriptive.

- For a code to be effective, shareowners have to have some power to enforce it. Plus, there must be robust disclosure by companies as to how they address the code.

- Asset owners as well as asset managers should be part of stewardship codes; the UK is likely to amend its stewardship code to address this in the future.²⁸

- Investors must have an effective framework to use for evaluation. Collaboration is crucial. Investors generally share resources and expertise, but it is not always an easy and natural thing to do, especially across borders. For a code to work well, investors must have tools to address accountability, as that is what gives a code ‘teeth.’

III. TOPIC 3: MAIN PARTICIPANT TAKEAWAYS

- Codes of corporate governance are about more than simple disclosure; codes help to provide certain benchmarks on which companies can be monitored and evaluated. Market consensus can be used as a way in which to define the relevant and applicable benchmarks.

- Governments are important to codes, either by offering a threat of legislation if codes fail to develop, or by building a framework of disclosure or shareholder rights that allow codes to function well.

- A potential weakness in applying European observations on codes of corporate governance in the U.S. is that corporate mobility is much different in the U.S. than it is in Europe. For instance, although Delaware is chosen by many companies as the state of incorporation, companies have the ability to change their state of incorporation.

D. SUMMARY OF ROUNDTABLE PARTICIPANT CONCLUSIONS

- A code should be founded on the aim of value creation rather than compliance.
- Code development needs one or more respected leaders.

²⁸ Financial Reporting Council (FRC), “The UK Stewardship Code” (July 2010). Available at: <http://www.frc.org.uk/images/uploaded/documents/UK%20Stewardship%20Code%20July%2020103.pdf>. Information on the consultation for changes for “The UK Stewardship Code” available at: <http://www.frc.org.uk/corporate/investorgovernance.cfm>.

VI. CORPORATE GOVERNANCE CODES IN THE U.S.

- Codes can best succeed if they involve all major parties to the capital market.
- A code needs to be holistic, addressing both corporate and investor behavior.
- Codes have advantages over regulation in that they are more flexible and are market-based. But there must be a clear understanding of where laws and regulations end and codes begin.
- A code should start with high-level issues such as board accountability and equal treatment of all shareowners.
- Funds cannot do code monitoring on an individual basis, but instead must support a collective monitoring body.
- Investor participation is critical to a code's success and funds must have authority to make directors accountable.
- There must be an understanding that codes are no panacea.
- Codes of corporate governance are about behavior and they can help to set behavior expectations.
- Codes can serve as a starting point for proxy advisors and individual funds in shaping voting and engagement behavior.
- The threat of law or regulation can motivate code development, but so can prospects of an exchange: for instance, loosening laws in certain areas in favor of a code.
- A successful code is one that reduces adversarial relations between boards and investors, and fosters quality dialogue between investors and directors.
- Stock exchanges may not be the most constructive path to code development as they are commercial, with little interest in taking steps that could dampen IPOs or concern members.

A. DOES THE U.S. HAVE CODES?

The U.S. has no single national, authoritative corporate governance code. However, that doesn't mean that codes are absent. Instead, the process of developing standards is decentralized. As of the middle of 2008, one analysis identified 25 unique codes.²⁹ The law firm of Weil, Gotshal & Manges LLP ("Weil"), in its widely-used "Comparison of Corporate Governance Principles & Guidelines: United States,"³⁰ compiled under the supervision of Holly Gregory, partner, Weil, Gotshal and Managers LLP reviews ten: the recommendations of the American Law Institute, the Business Roundtable's Principles, the National Association of Corporate Directors' (NACD) Report on Director Professionalism, the Conference Board's Recommendations, the Council of Institutional Investors' (CII) Policies, the California Public Employees' Retirement System's (CalPERS) Corporate Governance Principles, TIAA-CREF's Policy Statement, the AFL-CIO Voting Guidelines, and Institutional Shareholder Services' (ISS) Best Practices User Guide and Glossary. Weil includes the OECD Principles to put U.S. positions into a global perspective.

In each of these sets of guidelines, sponsoring organizations expressly state that standards are not intended to be rigidly prescriptive, nor are they envisioned to apply to all companies in all respects. The possibility and need for individual variation depending upon circumstances are stated to be fundamental. All of these codes are intended to be flexible enough to deal with special situations. In this respect, they closely follow their foreign counterparts.

Of the more than 40 categories compared by Weil, the various codes diverged widely on only nine, which included the following: separation of chair and CEO, naming of a lead independent director, board size, limitations on tenure, majority voting standard in non-contested elections, classified boards, availability of directors to meet with shareholders, compensation disclosure of specific executives, and the ability of shareholders to call special meetings. Even in these cases, the

²⁹ Ruth V. Aguilera and Alvaro Cuervo-Cazurra, "Codes of Good Governance," *Corporate Governance: An International Review*, May 2009.

³⁰ Weil, Gotshal and Manges LLP, "Comparison of Corporate Governance Principles & Guidelines: United States" (January 2012). Available at: http://www.weil.com/files/Publication/06cdf884-89df-4459-bb10-e08ab65e6172/Presentation/PublicationAttachment/9eo0eo8d-4cao-4c1d-9ccd-f680ob5066cd/Corp_Gov_Guidelines_Codes_Best_Practice_Jan2012.PDF.

divisions were not always radical, with silence taking the place of outright opposition. There was much substantial agreement among all ten codes reviewed by Weil, and more often among seven or eight, and especially among the “investor advocates” (CII, CalPERS, TIAA-CREF, the AFL-CIO, and to some extent, ISS).

On the other hand, there was tremendous variation in wording, emphasis, and many specifics. Each set of standards clearly bore the imprint of a different organization, of its concerns, its past campaigns, and its leadership. None appear to have been written with any of the other organizations much in mind. None appear to have been crafted with the aim of seeking agreement with others upon a particular rule or set of criteria.

To an extent, each of these codes also appears reactive: it reflects the experience of a particular group in dealing with a particular set of governance issues and disputes. In stark contrast to the OECD Principles (which, however, may be too general to be applied directly to any one country), none of these sets of guidelines makes a strong claim to universality, even in a purely U.S. context. The codes do not attempt to define governance from the bottom up, nor do they purport to cover all conceivable situations. The investors’ codes are very specifically intended to serve as guidelines either for those assigned the voting of proxies or to those trying to understand why a particular fund voted the way it did. On the other hand, the corporate codes are mostly designed to guide boards and corporate secretaries in reaction to the concerns of investors, especially in the wake of high-profile governance failures of the past twenty years. Typically, for both code-writing communities, issues which have most often been contentious (e.g., executive compensation) loom largest. Those of greater theoretical as well as practical import, but which are involved in proxy voting less often (such as separation of the chairman and CEO, the role of lead director, and succession issues), are dealt with at much less length.

B. WHAT ARE SOME OF THE REASONS WHY THERE EXISTS NO OVERARCHING CODE OF CORPORATE GOVERNANCE IN THE U.S.?

I. FEDERAL V. STATE

An important impediment to the U.S. creating an authoritative governance code is the historic tension between nation-wide standard-setting and state determi-

nation. There are constitutional barriers to setting company law at the national level. Corporations, for instance, are not federally chartered but, rather, “citizens” of one of the states. Most corporate regulation is a state matter. The federal government is allowed to be involved if it can invoke the Commerce Clause of the U.S. Constitution, but even in the 21st century, the Commerce Clause has limits. The SEC is allowed to regulate the marketing of securities and the distribution of prospectuses, proxy statements, and the like because these are distributed in a national marketplace that freely crosses state boundaries. The actual regulation of the corporations themselves is a different matter, however, and the SEC has been careful to observe that its jurisdiction has limits.

While some aspects of corporate governance leading practice might be similarly linked to the functioning of the capital markets, others would likely not be related. The composition and structure of boards, the use and limitation of poison pills and other anti-takeover defenses, the remuneration of senior executives, and so forth, are matters of state law. It is true that the recent Dodd-Frank Wall Street Reform and Consumer Protection Act established a requirement for a non-binding shareholder vote on a corporation’s compensation policies, and gave the SEC explicit authority to devise a rule for shareholders to have access to the proxy ballot.³¹ Both are issues for which corporate governance activists had fought for a long time. But these features were again justified as extensions of federal authority over the proxy-voting process. It would require a great deal of legal reasoning, which may be unlikely to be accepted by the nation’s courts, to bring all governance concerns under the same umbrella.

Governance codes, when applied in other jurisdictions, can help to define leading practices; they do not require incorporation into any specific legal framework. And indeed, the U.S. could have a ‘national’ code that would be the creation of an unofficial group of investors, business leaders, lawyers, and academics, which might be widely or even universally accepted as the uniform U.S. standard

³¹ This was subsequently vacated by the U.S. Court of Appeals upon a lawsuit lodged against the SEC by the Business Roundtable and the U.S. Chamber of Commerce. Available at: <http://www.cadc.uscourts.gov/internet/opinions.nsf/89BE4Do84BA5EBDA852578D5004FBBE/file/10-1305-1320103.pdf>.

of leading practice, but which would have no force of law or governmental support. However, there may be sectors of the market that feature cultural resistance to national guidance. This is in sharp contrast to experience outside the U.S., where national codes often have official status, with support from the relevant national regulators or statutory law and, second, the ability to require that public corporations either follow the principles enumerated by the code or publicly explain why they choose not to. It is these very characteristics which have helped to define a national code as authoritative and distinguished it from other widely-accepted guidelines.

The Financial Accounting Standards Board (FASB), which sets U.S. accounting standards, could present a model of quasi-official market parentage of a corporate governance code. However, it must be noted that accounting has always been accorded special status as an element of interstate commerce. It could be a singular challenge to gain multi-stakeholder agreement for a FASB-style governance standard-setter.

Stock exchange listing standards have become an important alternative to government sponsorship in attempts to impose higher standards of governance. Almost all U.S. publicly-traded corporations of any size are listed either on the New York Stock Exchange or on NASDAQ. In reaction to the accounting and disclosure scandals of 2001-2002, these two exchanges revised their listing requirements to include provisions involving director independence, board structure, and the like, as well as some further disclosure requirements.³² Governance standards changes made through the listing exchanges do not require specific enactments by Congress but do require subsequent ratification by the SEC (following a mandatory comment period and the execution of other SEC rule-making processes).

II. FRAGMENTATION

Another potential obstacle in the creation of a national code in the U.S. lies in the fact that market size, geographic dispersion, demographic diversity, and industrial segmentation fosters fragmentation among both corporates and investors. Views of parties involved in the discussion are often varied and, in some instances, contrary to each other. There is a chronic challenge in forging leadership that can deliver consensus opinion in each of the market's communities.

C. WHAT MIGHT BE THE CONSEQUENCES OF NOT HAVING AN AUTHORITATIVE NATIONAL GOVERNANCE CODE FOR THE U.S.?

Without an overarching code, debate over governance in the U.S. typically defaults to appeals for legislative action and black-letter regulation. Despite widespread sentiment on the part of participants on both sides of the governance debate that flexibility is important and that 'comply or explain' would be preferable to 'comply or else,' governance standards usually find their realization only in hard-and-fast regulation through statute, such as Sarbanes-Oxley, and the recent Dodd-Frank Wall Street Reform and Consumer Protection Act.

The commercial proxy advisory firms have often served as de facto standard-setters in the absence of a national code.

³² NYSE listing requirements available at: <http://nysemanual.nyse.com/LCMTools/PlatformViewer.asp?searched=1&selectednode=chp%5F1%5F4%5F3%5F3&CiRestriction=internal+AND+audit&manual=%2Flcm%2fsections%2Flcm%2Dsections%2F>. NASDAQ listing requirements available at: <http://nasdaq.cchwallstreet.com/NASDAQTools/PlatformViewer.asp?selectednode=chp%5F1%5F1%5F4%5F2%5F8&manual=%2Fnasdaq%2Fmain%2Fnasdaq%2Dequityrules%2F>.

VII. MILLSTEIN CENTER CODES AND STANDARDS PROGRAM

U.S. ROUNDTABLE AND NEXT STEPS

Participants in the second roundtable met at the Yale Club in New York City on March 29, 2012. The roundtable consisted of participants and representatives from the project's founding sponsors and a balance of representatives from public corporations and institutional investors. Discussion proceeded under the Chatham House rule.³³

In accordance with the agenda, the session was divided among three topics related to codes of corporate governance. The three main topics discussed included: (1) how codes of corporate governance have worked in European markets (including a briefing of the discussions that took place at the October 13, 2011, roundtable in Zeist); (2) whether a code of corporate governance could work in the U.S. to improve the relationship between corporate boards and investors; and (3) if a code was constructed for the U.S., what process might work to make it happen, and what might a U.S. code look like. Each topic was introduced by a discussant, after which the topic was opened for general discussion.

Although this summary reflects the general discussion at the roundtable, it is acknowledged that not all participants shared the same views on each topic. What follows is a summary of main points raised in the sessions for each of the three topics and summarizes the discussions held among the participants, not the opinions of the author. The full version of the meeting notes and summary may be found in Appendix C.

A. TOPIC 1: HOW HAVE GOVERNANCE CODES WORKED IN EUROPEAN MARKETS?

For the first topic, there was a briefing on takeaway points from the Zeist roundtable. In general, participants at the New York City roundtable expressed interest in learning about the codes experiences in Europe and whether those same experiences may be realized in the U.S., given similarities and differences between U.S. and European markets, corporations, regulations, and the like. There was particular interest around initial trepidations with codes in Europe and whether, and if so, how, these issues and concerns were eventually assuaged.

³³ Chatham House rule is defined as follows: "When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed." Available at: <http://www.chathamhouse.org/about-us/chathamhouse-rule-translations>.

Potential concerns with U.S. codes of corporate governance seemed to be largely related to the fragmented structure of regulation (e.g., by state), concerns that perhaps the U.S. system of corporate governance is already more thoroughly developed than systems within European countries prior to the development of codes of corporate governance, the system of disclosure requirements already in place within the U.S., and the concern that there are already a multitude of corporate governance requirements within the U.S. However, participants also discussed whether the corporate governance community taken as a whole could have more of a voice with a code of corporate governance than it does with the current system.

B. TOPIC 2: COULD A CODE OF GOVERNANCE IN THE U.S. IMPROVE THE RELATIONSHIP BETWEEN CORPORATE BOARDS AND INVESTORS?

Participants discussed the role of a code in defining a framework for communication. Codes of corporate governance should not just be about corporate/management/director responsibilities (although these should be outlined as well), but also about investor responsibilities via a stewardship code. However, it was important to participants to note that the success of a code in enhancing the relationship between directors and investors hinges on trust and confidence between shareholders and investors who help to frame the document, although the document should naturally encompass the views of all corporate governance stakeholders. Codes of corporate governance should also address environmental, social, and governance issues, and their development may be enhanced through the creation of codes on a sector or industry basis. Finally, a governance principles process only works if both corporations and investors treat recommendations not as a compliance exercise, but as related to value; this may help directors and investors to be properly motivated.

C. TOPIC 3: IF THE U.S. WERE TO CONSTRUCT AN AUTHORITATIVE CODE, WHAT PROCESS MIGHT WORK TO MAKE IT HAPPEN, AND WHAT MIGHT SUCH A CODE LOOK LIKE?

With regard to the third topic, there were many questions raised. What leads to the perceived need to have a code of corporate governance? Who is involved and who would lead and under what auspices? Is there a better path compared to what there is now in the U.S.? What are the potential costs and benefits? How is it made authoritative? Although the precedent in the U.S. is for the system of corporate governance to be largely set by regulation, participants discussed whether there is an argument for pre-emptively establishing a holistic corporate governance framework via a code in order to better

define roles and expectations and try to improve or safely reduce risks. In fact, some participants argued that corporations may welcome a single set of standards rather than attempting to monitor and apply multiple standards that are sometimes inconsistent. Although the U.S. has several different “implied” codes of corporate governance, there is no one, single authoritative code; on substance, differences between codes turn out to be relatively small in comparison to the similarities, so it may be good to work on those similarities as a baseline. In order to make such an effort successful, it is important to have the right leader, someone who is heavily involved in the capital markets. Additionally, in development, it will be necessary to ground a code in the objectives of value creation, capital formation, and capital preservation. Given experience in Europe with the ‘comply or explain’ model (i.e., some companies incorrectly saying that they comply or incorrectly providing an explanation saying why they do not comply when, in fact, they are in compliance), and given its focus on the compliance aspect, many participants recommended that any code efforts within the U.S. be organized around the idea of ‘apply and explain’ in which it is not viewed as a “compliance” exercise, but rather as a company’s demonstration of commitment to corporate governance.

D. NEW YORK ROUNDTABLE CONSENSUS ITEMS

- I. There are sufficient grounds for taking the U.S. governance principles project to the next step.
- II. An effort to develop national, authoritative principles for the U.S. should be led by the private sector rather than by any public authorities.
- III. The project should focus on the term “principles” rather than “code” and should address ultimate aims such as capital formation and preservation. In this way, governance may be understood as a means rather than an end in itself.
- IV. A set of U.S. principles should embrace both corporations and institutional investors.
- V. An independent, balanced, multi-stakeholder body unaffiliated with any single market participant is necessary to achieve progress.
- VI. The leader of such a group is critical; it should be someone from the capital markets world with

wide recognition, commitment, and respect.

VII. Development of content need not start from scratch. Many organizations have developed principles and provisions of their own on corporate governance, and these recommended provisions share much common ground. More work would have to be spent on principles related to institutional investors (e.g., stewardship codes).

VIII. Reporting on a set of U.S. principles should be framed as ‘apply and/or explain’ rather than ‘comply or explain.’

IX. A work plan could unfold in the following phases:

1. review project feasibility, develop project governance structure as an independent entity, and identify and appoint a chair;
2. draft principles and issue them for market consultation;
3. finalize principles;
4. consider mechanisms for implementing an ‘apply and/or explain’ reporting via channels such as stock exchange listing rules.

APPENDIX A

GOVERNANCE CODES AND STANDARDS PROGRAM: BRIEFING MEMO

PROJECT OVERVIEW

The Millstein Center for Corporate Governance and Performance at the Yale School of Management has begun a multi-year effort designed to encourage research into, and disseminate further knowledge of, international experience in the field of corporate governance codes and standards.

The first phase of the project is to consist of (1) a call for papers by scholars on the general topic of governance standards, with an opportunity for select authors to present at a March 2012 Yale workshop and publish their research as Center working papers; (2) two roundtables of both practitioners and academics focused on experience with codes; and (3) publication of one or more authored working papers on the topic in order to set the stage for what a combined code of corporate governance is and current state of play, drawing from international sources and experiences.

The first roundtable discussion takes place in Zeist, The Netherlands on 13 October 2011. A second roundtable discussion is to be held in New York in spring 2012. The purpose of these events will be to discuss the role, impact, and effectiveness of corporate governance codes. Sponsored by Yale School of Management's Millstein Center for Corporate Governance and Performance, and hosted by PGGM, the first roundtable meeting will bring together a select group of thought-leader EU corporate directors, investors, regulators, code authors, and experts to address this key aspect of corporate governance. The roundtable is, in part, designed to inform discussion in the U.S. about the merits and risks of a national authoritative code of corporate governance. Discussion is to focus on lessons to be learned from the European experience so far. Insights may also further discussion in the EU on the utility, context, and consequences of codes.

In addition to the 13 October EU roundtable (and later U.S. roundtable), the Center has also released a call for papers for existing and original research on the role and impact of corporate governance codes.

The Center has assembled an advisory committee consisting of scholars and practitioners to help provide steering guidance for the project. Project sponsors with the Center are PGGM, TIAA-CREF, Microsoft, Prudential Financial, and Deloitte.

The scientific committee overseeing the call for papers is comprised of Marco Becht (Université Libre de Bruxelles); Martijn Cremers (Yale School of Management); Andrew Metrick (Yale School of Management); and Colin Meyer (Oxford Said School) and is coordinated by Stephen Davis (Yale School of Management).

BACKGROUND INFORMATION

The field of corporate governance is growing, especially given the numerous legislative reforms in this field as a result of economic crises. Codes have drawn particular notice from policymakers. For instance, in the U.S., there is incipient interest in the utility of a possible authoritative set of national corporate governance principles. European policymakers, for their part, are leaning heavily on 'comply or explain' standards; the April 2011 EU Green Paper on corporate governance includes a detailed section on codes.³⁴ But codes have so far drawn less attention from scholars, leaving gaps in knowledge even as policymakers try to evaluate the prospective or past impact of such practices.

Academic literature on corporate governance codes was last surveyed in 2009 in a paper by Aguilera and Cuervo-Cazurra,³⁵ in which the two observed that "there is little systematic analysis of how codes of good governance have affected how corporations are structured or how managers behave across different governance systems." Research has largely focused on comparing the content of codes from one market to another, and on the extent of compliance with codes by companies in particular jurisdictions. According to the research, literature that attempts to test whether corporations or investors receive value from corporate governance codes is conflicting or inconclusive; "a key puzzle that needs to be resolved in research on codes of good governance is whether they have an impact on firm performance."

DISCUSSION TOPICS / TOPICS OF INTEREST

Gaps in current knowledge impede insight on whether corporate governance codes provide value, to whom, and

³⁴ European Commission, "GREEN PAPER: The EU Corporate Governance Framework" (April 2011). Available at: http://ec.europa.eu/internal_market/company/docs/modern/com2011-164_en.pdf. Information on the consultation available at: http://ec.europa.eu/internal-market/consultations/2011/corporate-governance-framework_en.htm.

³⁵ Ruth V. Aguilera and Alvaro Cuervo-Cazurra, "Codes of Good Governance," *Corporate Governance: An International Review*, May 2009.

under what circumstances, and whether they introduce other intended or unintended consequences to markets. For example, market participants are hampered in assessing whether a common, voluntary, private sector-written code of corporate governance might be relevant to the U.S.; or whether such codes are effective alternatives to statutory reform in Europe and Asia and, if they are, in what form.

Topics for discussion at the Zeist roundtable event on 13 October include the following:

- Do corporations see corporate governance codes as affecting performance over the short, medium, or long term, and how do they view costs and benefits?
- How do investors take national corporate governance standards into account when shaping their behavior in respect to investing, engagement, and voting?
- Do the ways in which codes are formulated and implemented affect outcomes such as the behavior of market participants? How?
- Cost-benefit analyses of applying standards at corporations or across a market;
- Whether disparities among national guidelines prompt code arbitrage—for instance, persuading companies to reincorporate or switch stock exchange listings to take advantage of different standards elsewhere;
- Whether, and to what extent, the ways in which codes are formulated and implemented affect outcomes such as the behavior of market participants;
- Whether codes affect the behavior of influential intermediaries such as proxy advisors, remuneration consultants, auditors, or others;
- A comparative analysis of the content of codes and outcomes across jurisdictions; and
- Whether codes can be thought of as exogenous changes in corporate governance (or to what extent).

Each of these discussion topics will be led by a participant at the roundtable event, and participation by other roundtable attendees is strongly encouraged.

Additionally, as noted above, the codes project features an academic component (via a call for papers). Research may help to inform policy debate in the following non-exhaustive areas:

- How investors may take national corporate governance standards into account when shaping their own behavior in respect to investing, engagement, and voting;
- Whether it is possible to identify corporate governance variables that most affect company performance;
- Whether the presence of authoritative governance standards affects the incidence or type of legal actions taken against corporations;
- Whether there is a distinction in the application of codes to financial institutions as opposed to other firms;

APPENDIX B

GOVERNANCE CODES AND STANDARDS PROGRAM CALL FOR PAPERS

The Millstein Center for Corporate Governance and Performance at the Yale School of Management has begun a multi-year effort designed to encourage research into, and disseminate further knowledge of, international experience in the field of corporate governance codes and standards. The Center is requesting proposals for existing and original research on the role of corporate governance codes and standards, as developed and implemented by governments, private sectors, commercial bodies, and the like, on markets, regulation, investors, company performance, and behavior, or the practices of intermediaries. Submissions are encouraged from all academic disciplines including, but not limited to, finance, corporate governance, corporate social responsibility, international business, economics, and law. Selected authors may participate in a conference scheduled to take place at Yale University in March 2012.

PROJECT OVERVIEW

The field of corporate governance is growing, especially given the numerous legislative reforms in this field as a result of economic crises. Codes have drawn particular notice from policymakers. For instance, in the U.S., there is incipient interest in the utility of a possible authoritative set of national corporate governance principles. European policymakers, for their part, are leaning heavily on ‘comply or explain’ standards; the April 2011 EU Green Paper on corporate governance includes a detailed section on codes.³⁶ But codes have so far drawn less attention from scholars, leaving gaps in knowledge even as policymakers try to evaluate the prospective or past impact of such practices.

Academic literature on corporate governance codes was last surveyed in 2009 in a paper by Aguilera and Cuervo-Cazurra,³⁷ in which the two observed that “there is little systematic analysis of how codes of good governance have affected how corporations are structured or how managers behave across different governance systems.” Research has

largely focused on comparing the content of codes from one market to another, and on the extent of compliance with codes by companies in particular jurisdictions. According to the research, literature that attempts to test whether corporations or investors receive value from corporate governance codes is conflicting or inconclusive; “a key puzzle that needs to be resolved in research on codes of good governance is whether they have an impact on firm performance.”

TOPICS OF RESEARCH

Gaps in current knowledge impede insight on whether corporate governance codes provide value, to whom, and under what circumstances, and whether they introduce other intended or unintended consequences to markets. For example, market participants are hampered in assessing whether a common, voluntary, private sector-written code of corporate governance might be relevant to the U.S.; or whether such codes are effective alternatives to statutory reform in Europe and Asia and, if they are, in what form. This call for papers is largely focused on understanding the relationship between corporate governance codes and whether these codes have an association with firm behavior and performance, or with the behavior of investors or intermediaries such as proxy advisors, auditors, remuneration consultants, or others. Papers that attempt to first study what, if any, changes occurred in association with the appearance of codes, and then to what extent these changes tell us anything about the potentially causal relationship between governance and performance, are welcomed.

Research may help to inform policy debate in the following non-exhaustive areas:

- How investors may take national corporate governance standards into account when shaping their own behavior in respect to investing, engagement, and voting;
- Whether it is possible to identify corporate governance variables that most affect company performance;
- Whether the presence of authoritative governance standards affects the incidence or type of legal actions taken against corporations;
- Whether there is a distinction in the application of codes to financial institutions as opposed to other firms;

³⁶ European Commission, “GREEN PAPER: The EU Corporate Governance Framework” (April 2011). Available at: http://ec.europa.eu/internal_market/company/docs/modern/com2011-164_en.pdf. Information on the consultation available at: http://ec.europa.eu/internal_market/consultations/2011/corporate-governance-framework_en.htm.

³⁷ Ruth V. Aguilera and Alvaro Cuervo-Cazurra, “Codes of Good Governance,” *Corporate Governance: An International Review*, May 2009.

- Cost-benefit analyses of applying standards at corporations or across a market;
- Whether disparities among national guidelines prompt code arbitrage—for instance, persuading companies to reincorporate or switch stock exchange listings to take advantage of different standards elsewhere;
- Whether, and to what extent, the ways in which codes are formulated and implemented affect outcomes such as the behavior of market participants;
- Whether codes affect the behavior of influential intermediaries such as proxy advisors, remuneration consultants, auditors, or others;
- A comparative analysis of the content of codes and outcomes across jurisdictions;
- Whether codes can be thought of as exogenous changes in corporate governance (or to what extent).

SUBMISSION OF PROPOSALS

Scholars are invited to submit proposals, including a 2 to 3 page abstract and outline of their proposed research project along with a current CV, by July 1, 2011. Topics not specifically mentioned in these pages that fit within the project parameters are welcome. There is no submission fee. Papers must be in English.

A scientific committee of distinguished scholars from Yale and other institutions will select approximately eight papers. Awardees will be notified by August 15, 2011. Completed papers will be expected by December 14, 2011. The conference is tentatively scheduled for March 2012. The Center will also endeavor to identify papers for publication in book form.

The scientific committee for the project is coordinated by Stephen Davis, Ph.D., executive director of the Millstein Center, and composed of:

- Marco Becht, Professor of Finance and Economics at Université Libre de Bruxelles and executive director of the European Corporate Governance Institute;
- K.J. Martijn Cremers, Associate Professor of Finance, Yale School of Management;

- Colin Mayer, Peter Moores Dean of Said Business School and Peter Moores Professor of Management Studies, Oxford University; and
- Andrew Metrick, Deputy Dean for Faculty Development and Michael H. Jordan Professor of Finance and Management, Yale School of Management.

The Millstein Center may make available upon request and review a U.S.\$2,000 award to authors of each selected paper to support research required for completion of the paper. In addition, for those papers accepted for presentation at the Millstein Center academic conference, organizers will pay for travel by one presenter per paper to Yale University, the conference location, along with room and board in New Haven, CT USA for the duration of the event.

If you wish to have your paper considered for presentation at the conference, please submit your abstract or paper electronically as a Word or PDF document. If requesting award funding towards data purchase or research support, please provide a budget breakdown. All identifying information should be attached via a separate page, and the submission sent via email to:

Contact: Michele Grammatico, Administrator, Millstein Center for Corporate Governance and Performance, email: michele.grammatico@yale.edu.

APPENDIX C

MEETING SUMMARY AND NEXT STEPS YALE CODES AND STANDARDS NEW YORK CITY PROGRAM ROUNDTABLE 2 NEW YORK CITY MARCH 29, 2012

I. OVERVIEW

The Millstein Center created the Codes and Standards Program in 2011 to probe international experience with national, authoritative codes of governance for corporations and investing institutions, and to identify lessons useful to any effort to develop such principles for the U.S. Founding sponsors for the project, along with the Millstein Center, were two large investors in U.S. equity (PGGM and TIAA-CREF); two U.S. public corporations (Microsoft and Prudential Financial); and Deloitte. The project's first year, aimed at fact finding, had four components: (1) an academic call for papers on codes; (2) an October 2011 roundtable in Zeist to review experience with codes in Europe; (3) a March 2012 roundtable in New York to discuss the relevance of a U.S. code; and (4) a working paper with research and background on codes together with practitioner perspectives drawn from the two roundtables.

Participants in the second roundtable met at The Yale Club in New York City on March 29, 2012. The roundtable consisted of participants and representatives from the project's founding sponsors and a balance of representatives from public corporations and institutional investors. Discussion proceeded under the Chatham House rule.³⁸

This memorandum starts with the consensus agenda reached at the conclusion of the roundtable and then summarizes discussions that led up to it.

II. CONSENSUS ITEMS

A. Following a three-part discussion lasting over four hours, participants in the New York roundtable reached consensus on the following points:

- I. There are sufficient grounds for taking the US governance principles project to the next step.

³⁸ Chatham House rule is defined as follows: "When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed." Available at: <http://www.chathamhouse.org/about-us/chathamhouse-rule-translations>.

II. An effort to develop national, authoritative principles for the U.S. should be led by the private sector rather than by any public authorities.

III. The project should focus on the term "principles" rather than "code" and should address ultimate aims such as capital formation and preservation. In this way, governance may be understood as a means rather than an end in itself.

IV. A set of U.S. principles should embrace both corporations and institutional investors.

V. An independent, balanced, multi-stakeholder body unaffiliated with any single market participant is necessary to achieve progress.

VI. The leader of such a group is critical; it should be someone from the capital markets world with wide recognition, commitment, and respect.

VII. Development of content need not start from scratch. Many organizations have developed principles and provisions of their own on corporate governance, and these recommendations share much common ground. More work would have to be spent on principles related to institutional investors.

VIII. Reporting on a set of U.S. principles should be framed as "apply and/or explain" rather than "comply or explain."

IX. A work plan would unfold in the following phases:

1. review project feasibility, develop project governance structure as an independent entity, and identify and appoint a chair;
2. draft principles and issue them for market consultation;
3. finalize principles;
4. press for apply and/or explain reporting via channels such as stock exchange listing rules.

III. IMMEDIATE NEXT STEPS

- A. Circulate this memorandum for feedback and produce a final version. (The version included within this appendix represents the final version.).
- B. Convene a conference call meeting of the project's founding sponsors (Deloitte, Microsoft, Millstein Center, PGGM, Prudential Financial, and TIAA-CREF) in mid-May to address the work plan as per above.
- C. Convene an in-person meeting of the founding sponsors in June 2012 at Yale.
- D. Circulate recommendations to and invite comment from New York roundtable attendees.
- E. Produce the final Millstein Center working paper on codes of corporate governance prior to the Yale Governance Forum.
- F. Provide exposure of progress to the governance community via the 2012 Yale Governance Forum. A plenary session on June 7, 2012 is entitled "Corporate governance codes around the world: Lessons for the US?". Discussants and respondents, many of whom attended at least one of the project roundtables, will review perspectives developed so far in the project.
- G. Finalize a project governance structure and appoint a chair.

IV. NEW YORK ROUNDTABLE DISCUSSION NOTES

The March 29, 2012, roundtable in New York followed a three-part agenda that ended in the discussion of consensus items above. Topics were (1) How have governance codes worked in European markets?; (2) Could a code of governance in the United States improve the relationship between corporate boards and investors?; and (3) If the U.S. were to construct an authoritative code, what process might work to make it happen, and what might such a code look like?

- A. Topic 1: How have governance codes worked in European markets?

I. The session opened with a briefing, and then group discussion, on main insights from the project roundtable convened in Zeist in October 2011. Following are the main takeaways from Zeist:

- 1. Discussion at the Zeist roundtable focused on those living with codes – corporates, investors, intermediaries, public policy sectors – and their views on the following 3 topics: codes and performance; codes and investor decisions; and codes and behaviors they effect
- 2. A code is a means and not an end – codes are not intended to be a cure-all, but merely to be a starting point
- 3. Even if there is a code of corporate governance, investors may still put pressure where they want it to be put
- 4. Codes of corporate governance are about setting behavior expectations, including both corporates and investors; there should be a stewardship component to codes of corporate governance
- 5. Investor participation is critical to a code's success and funds must have governance muscle – namely powers to oust directors – for a code to work
- 6. Code development should start with high level issues, such as board accountability and equal treatment of all shareowners
- 7. Codes should be developed on the aim of value creation rather than on compliance and they should be holistic, encompassing all major parties to the capital market
- 8. Throughout the development of a code, and after it is developed and in need of traction in the market place, it needs to involve one or more respected leaders
- 9. Successful codes will help to reduce adversarial relations between boards and investors and can help to foster quality dialogue
- 10. Generally, code frameworks are principles-based (i.e., flexible) rather than rules-based and often embrace the idea of 'comply or explain' – either (1) complying with the provisions of the code, or (2) giving a well-reasoned and informative disclosure about why the company is not in compliance with the code; either are intended to be equally acceptable; boiler-plate responses will not work best, and it is important for the market to determine whether companies have appropriately complied or adequately explained

- 11. The threat of law or regulation can motivate code development, but so can prospects of an exchange: for instance, loosening laws in certain areas in favor of a code
 - 12. It is important to definitively identify where the law stops and the code of corporate governance begins; codes are an important substitute for and, in some instances, a complement to, regulation; codes may have advantages over regulation in that they are more flexible and are market-based
 - 13. The vitality of a code of corporate governance rests on the participation of investors both in the formulation of the code originally and on the monitoring component to see that covered parties are following and are in compliance; funds cannot do monitoring at an individual basis but instead must support a collective monitoring body
 - 14. Codes are a starting point for proxy advisors and individual funds in shaping voting and engagement behavior; a key challenge, though, is involving non-resident investors in applying codes
- II. Discussion of Zeist roundtable summary at the U.S. roundtable:
- 1. Generally, the corporate governance community within Europe has found codes to be helpful; they provide a framework for how to start the conversation and also help to define expectations; codes help to provide clarity around roles and responsibilities of investors and corporates; some of the initial fears about codes of corporate governance have started to subside
 - 2. Codes develop over time and build upon themselves; code development should start with what the optimal outcome should be; it is important to have a process in place in order to perform a review of the code for any updates that may be necessary
- III. Thinking in the U.S. about codes of corporate governance
- 1. Corporates and investors in the U.S. have been the ones that have developed their own corporate codes
 - 2. Trying to compare potential provisions at the code level across the U.S. is difficult because it requires knowledge of all requirements throughout the U.S.
 - 3. In the U.S., there is a disclosure system (rather than a 'comply-or-explain' system); from the outside looking in, it looks like everything is regulated, but it is more about disclosure
 - 4. When thinking about the European experience, it may be useful to think how much of the corporate governance landscape was already filled-in by the time codes came into existence; in the U.S., a lot of the landscape has already been set through regulation, so codes may not be as useful
 - 5. Given much of the recent legislation, most corporates are trying to work through requirements associated with the regulation and their associated action plans
 - 6. With a code, the corporate community could have more of a voice than with the current system
- B. Topic 2: Could a code of governance in the United States improve the relationship between corporate boards and investors? Points raised by participants included:
- I. Principles could improve the relationship between corporate boards and investors by defining a framework for communication. There is a need for guidance, in part because of concerns over breaching Regulation FD, and in part because of long-standing resistance among some boards to taking on responsibility of dialogue with shareowners.
 - II. Development of successful authoritative principles hinges on trust and confidence between shareholders and investors who frame the document.
 - III. Code creation should be put into the context of performance, value creation, capital formation, and capital preservation.
 - IV. A governance code can help improve relations between management and boards by clearly spelling out responsibilities of the two. Today, directors and executives may need additional clarification about roles.

- v. The existence of a code could affect the way proxy advisory firms make judgments. In the U.S., in the absence of a code, they tend to act as default standard-setters. By contrast, in a market with an authoritative code, they tend to use the code as the standard and make recommendations based on it.
- vi. A governance code could be framed first for a sector or industry to reflect common characteristics.
- vii. Codes of corporate governance should include environmental, social, and governance risks.
- viii. One lesson from the European experience is that a code of governance should address both corporations and the behavior of shareowners. Otherwise, there is a risk of making boards responsive, but to institutions acting in ways that may seek short term outcomes despite long term interests of clients.
- ix. The way in which a code gets traction is by encompassing the views of all major parties in a market; it needs broad buy-in.
- x. A governance principles process only works if both corporations and investors treat recommendations not as a compliance exercise, but as related to value. Then directors and investors will be properly motivated.
- c. Topic 3: If the U.S. were to construct an authoritative code, what process might work to make it happen, and what might such a code look like? Points raised by participants included:
- I. Questions to ask:
 1. What leads to the perceived need to have a code of corporate governance?
 2. Who is involved?
 3. Who would lead and under what auspices?
 4. Who wants a code (i.e., if it isn't broken, do not fix it)?
 5. Is there a better path compared to what exists now in the U.S.?
 6. What are the potential benefits?
 7. Who would lead the exercise?
 8. How does the project get done and implemented?
 9. How does the project get buy-in?
 10. Are potential problems solved through listing standards rather than through a code?
 11. Will the right and necessary actors "come to the party?"
 12. Are there public policy issues that should be addressed in the code?
 13. How can the code be made authoritative?
- II. The common U.S. practice is to turn to regulation, but maybe this should not be the preferred choice
- III. The goal of the code may be to stabilize the markets and try to improve or safely reduce risks
- IV. It may be necessary to have some form of public agency involvement in order to make it authoritative
- V. The U.S. has several different codes of corporate governance, but not one, single authoritative code; on substance, differences between codes turn out to be small in comparison to the similarities, so it may be good to work on those similarities as a baseline
- VI. Before actually constructing and developing a code, it is important to first determine who would sponsor such an initiative and what the convening force would be
- VII. A code does have value and could be useful in the U.S.
1. It was recommended by some that the code-writing leader be someone who is independent; must be free of any potential conflicts that could make it appear that the sponsor is using the code as a tool for something; others suggested that because the U.S. has such a deep rooted rules-based system, any adoption of a code would need a lot of muscle, and this may perhaps best be served by someone heavily involved in the capital markets; leadership will be extraordinarily important
 2. A potential path to development of authoritative principles would be for a group to compose a potential code and then to try to find someone with muscle to get involved; however, many thought that

APPENDIX D

it was essential for the person with the strength to be identified first and inherently involved with the creation of the code

3. Another important element is funding; it would be necessary to have some basic funding, but that individuals providing the funding not be able to control the agenda in any way

4. Cannot convene a group open to everyone; should be a group of 10 to 15 people who may have divergent opinions, but who are open minded; could include regulators, corporates, institutional investors, and risk managers; may not want to include stock exchanges; the goal is to achieve a common framework, and regulation is probably not the best way to do it

5. It will be necessary to have practical proposals – need to argue for certain codes provisions from an economic perspective

6. Necessary to have a stewardship component to any potential code that is developed

7. May be necessary to agree that certain issues that may be included within a code of corporate governance may have to be pushed to a second phase in order to get widespread approval on the first phase

8. The task should be defined with a sense of urgency; need to frame it from the perspective of being of critical importance to the economy and society

9. Any code should be focused on performance, value creation, capital formation, and preservation

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