BUSINESSEUROPE

POSITION PAPER

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CONSULTATION ON THE EU CORPORATE GOVERNANCE FRAMEWORK

EXECUTIVE SUMMARY

- Good and efficient corporate governance is of utmost importance to companies and their stakeholders. It ensures long-term sustainability, streamlines the relationship between a company and its stakeholders and it is one of the elements that can help restore confidence in the internal market.

- There is no one-size-fits-all solution in this area. The legal environment differs from Member State to Member State – especially with the difference between one-tier and two-tier boards. Companies should have the flexibility to design effective corporate policies tailor-made to their corporate objectives and goals.

- Keeping a balance between professional regulation (soft law) and hard law is key in this area. Solutions based on 'hard law' should be kept to a minimum and only for those aspects where professional regulation cannot provide satisfactory results. In this fast-moving area, corporate governance codes are the best means of promoting the right corporate behaviour. They are flexible, easy to implement and update and allow for deviations (with explanations).

- Any EU intervention in this area should be based on sound empirical and scientific evidence and should respect the following principles: subsidiarity, principle-based approach, market-driven approach, comply or explain, transparency and disclosure, global orientation and better regulation.

- BUSINESSEUROPE agrees that the 'comply or explain' principle should be strictly applied and that whenever a company departs from a provision of a code, it should explain why and, if it is the case, include particulars of the alternative solution chosen.

- BUSINESSEUROPE believes that many of the issues raised by the green paper pertain to national corporate governance codes. In most of these areas there is no need for EU legislative intervention. Emphasis should rather be shifted from more regulation to better monitoring and effective application of legislation or corporate governance codes.

- The EU should avoid falling into the trap of over-regulation. This could hamper or even stop market-driven evolution of corporate governance practices, disrupt the delicate balance found at national level and might also lead to 'regulatory fatigue'.

I. INTRODUCTION

BUSINESSEUROPE welcomes the opportunity to submit its comments in the context of the consultation on the EU corporate governance framework.

Before addressing some of the specific questions contained in the green paper BUSINESSEUROPE would like to reiterate the principles that must serve as a reference for EU intervention or non-intervention in the area of corporate governance.

Principles for an EU approach to corporate governance

- **Subsidiarity** – The EU should only intervene when it is proven that the foreseen objective cannot be reached by national action. EU action should not disrupt the delicate balance found at national level, which takes into account national traditions and cultures.
- **Principle-based approach** – In light of the subsidiarity principle, in any EU intervention, a general principles-based approach should prevail over a rules-based approach. This would allow a degree of flexibility necessary for companies to develop the governance model best suited to them.
- **Market-driven approach** – In BUSINESSEUROPE's view, corporate governance is better served by flexible self-regulatory initiatives as opposed to external regulation. Over-regulating is a disincentive for companies to go beyond legislation and adopt corporate governance best practices.
- **'Comply or explain'** – When a corporate governance code is applicable, companies should either conform to the provisions of that code, or provide an explanation as to why the principles have not been followed. As stated in the 1992 Cadbury Report, the 'comply or explain' route should enable companies to "*strike the right balance between meeting the standards of corporate governance expected of them and retaining the essential spirit of enterprise… Raising standards of corporate governance cannot be achieved by structures and rules alone (...)*". This 'comply or explain' approach has been in operation for more than ten years and the flexibility it offers has been widely welcomed both by company boards and by investors. This wide acceptance has been revealed by the recent external study performed by Riskmetrics published in September 2009. Most companies – 86% of the sample taken – disclosed 'comply or explain' information although this study suggests room for improvement in terms of level and quality of information on divergences, and on the level of monitoring by shareholders and authorities.
- **Transparency and disclosure** – Transparency is an essential ingredient for any form of outside monitoring. It is very important for the shareholders and investors to see the manner in which a company follows the recommendations on corporate governance. Transparency enhances confidence in a company.
- **Global orientation** – EU policy should be oriented towards and take into account the global environment in which European companies inevitably evolve. Adding an additional and possibly contradictory EU layer of regulation would be a hindrance to achieving the goals of corporate governance.

- **Better regulation** – Impact assessments and proper consultations are the basis of good regulation. Consultation remains one of the basic principles of participatory democracy but consultation needs to be carried out in the right conditions: sufficient time for considered responses and a weighted analysis of responses received are fundamental ingredients for successful consultations.

- **No 'one-size-fits-all'** – in corporate governance '*one size does not fit all*'. The legal environment differs from Member State to Member State – especially with the difference between one-tier and two-tier boards. Furthermore, companies should have the flexibility to design effective corporate policies tailor-made to their corporate objectives and goals. The recent report of the Reflection Group On the Future of EU Company Law correctly states[1]: '*The different corporate governance systems of the Union should not be viewed as an obstacle to free enterprise within a single market, but as a treasure trove of different solutions to a wide variety of challenges that has been experienced and overcome. Differences in legal regimes are no more an obstacle to cross-border commercial activities than are differences of culture, language and geography*'.

In BUSINESSEUROPE's view, these principles should remain the main guidance for EU policy-makers. The philosophy of corporate governance rules in the EU is based on professional regulation, starting with the Forth Directive on Company Law. Regrettably, this is not sufficiently emphasised in the green paper.

Last but not least, sound corporate governance is only one of the elements needed to help restore confidence in the internal market. This is why it is crucial to ensure that other policies that also have an impact on the single market (for example fiscal, labour and financial law) are properly coordinated.

II. BUSINESSEUROPE's response to specific questions of the green paper

BUSINESSEUROPE believes that many of the issues raised by the green paper pertain to national corporate governance codes. In most of these areas there is no need for EU legislative intervention. Emphasis should rather be shifted from more regulation to better monitoring and effective application of legislation or corporate governance codes.

Preliminary questions

Question (1) - Should EU corporate governance measures take into account the size of listed companies?

A differentiated corporate governance regime for small listed companies is appealing, but it could become yet another barrier for growth if passing a certain threshold would oblige the company to adapt to and report on a more extensive corporate governance framework. Furthermore, the definition of what constitutes a "small listed company" differs among Member States which would make it difficult to find a uniform EU definition. In addition, we should not only think in terms of size but also in terms of ownership structure.

BUSINESSEUROPE does not see the need for EU intervention in this area.

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[1] Report of the Reflection Group On the Future of EU Company Law, 5 April 2011, p. 11 *in* http://ec.europa.eu/internal_market/company/docs/modern/reflectiongroup_report_en.pdf

The solution for small listed companies can be found in the existing corporate governance framework and the 'comply or explain' principle. In many Member States, codes already provide a regime more adapted to the reality of small listed companies. This is the proper route to address this issue. Deviations from the relevant corporate governance codes and a fulfilling explanation as to why the company does not comply could very well be sufficient.

Question (2) - Should any corporate governance measures be taken at EU level for unlisted companies?

Unlisted companies differ widely (e.g. size, ownership structure, etc.) which makes it even more difficult to develop and adopt a uniform corporate governance framework suitable for all unlisted companies.

It would be a tremendous burden on small unlisted companies if they were to be obliged to report on corporate governance codes and principles.

The subsidiarity principle must prevail when EU action in the area of corporate governance for unlisted companies is considered. The cross-border element does not seem sufficient to justify any EU action. The corporate governance challenges that unlisted companies may face due to their specific characteristics seem to be best taken care of at national level and with a market-driven approach. Unlisted companies should remain free to apply voluntarily national codes of corporate governance if they view it as necessary.

In addition, increasing the regulative burden on unlisted companies and reducing the differences between listed and unlisted companies will not make the listing more attractive.

1. Boards of directors

Question (3) - Should the EU seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officer are clearly divided?

In BUSINESSEUROPE's view it has not been demonstrated that corporate governance is improved by splitting those two functions. This should be a voluntary matter for the company's board and its shareholders, having regard to its relevant national code.

Question (4) - Should recruitment policies be more specific about the profile of directors, including the chairman, in order to ensure that they have the right skills and that the board is suitably diverse?

BUSINESSEUROPE believes that board composition is a corporate governance code issue, on which the principle 'comply or explain' should be applied. We see no need for measures at EU level aimed at harmonising existing national rules or corporate governance codes.

Companies' needs in terms of the profile of its directors can vary over time. The experience, qualifications and other relevant skills of nominated and incumbent directors should be disclosed so that shareholders can take an informed decision in the designation of directors.

It is essential that shareholders receive proper and timely information on candidates nominated for the board. However, the corporate governance framework should not require that companies adopt a specific recruitment policy describing the profile of board members nor impose further disclosure obligations.

Information on the background of the company's directors is already accessible through the company annual reports or company websites.

Question (5) - Should listed companies be required to disclose whether they have a diversity policy?

Diversity among non-executive board members can contribute to the well-functioning of the supervisory board. Diversity must, however, be regarded in a broad way, not only in terms of gender and in this context we agree with the approach taken by the Commission.

Mixed compositions of decision-making personnel often display a greater array of skills as well as better innovation, creativity and communication processes. Diverse boards usually provide a better reflection of a firm's customer base and promote a positive corporate image and greater credibility in the eyes of the public.

Still, for BUSINESSEUROPE skills and competence are the single most important factor when appointing board members. Diversity is an important factor but cannot come at the expense of the first two.

It is not possible for regulations to ensure that each board gets the most efficient and diversified composition. In fact, regulations which endeavour to do so, may very well be counterproductive as these would restrict the free choice between candidate board members in that they could disqualify candidates which would otherwise qualify in all respects. It ought to be the competent corporate bodies which freely and voluntarily decide what the key qualifications for board members are.

Question (6) - Should listed companies be required to ensure a better gender balance on boards? If so, how?

BUSINESSEUROPE fully supports the main objective of increasing the proportion of women in decision-making positions.

However, BUSINESSEUROPE believes that the introduction of legally binding targets (quotas) at European level is not the right way to approach the issue of career progression. They:

- Do not address the real causes of the low proportion of women in board positions.
- Interfere with private ownership and shareholders' rights to make decisions about the company.
- Set unrealistic timeframes and unsustainable targets.
- Might lead to hiring people who are not the best suited for the position.

Companies are increasingly aware of the benefits of having a more gender-balanced management structure and are actively setting strategic objectives and voluntary goals to achieve a better gender balance.

These actions can play an important role in accelerating these changes. For example:

- In Finland and Sweden corporate governance codes set a 'comply or explain' obligation to increase gender diversity in boards.

  In both countries the number of women on boards has steadily increased as more and more women have entered boards. As a result, the number of women in the largest listed companies in Finland and Sweden has more than doubled in the past 10 years to 26 percent. All of this has been achieved without quotas.

- In 2010 France, the code of corporate governance AFEP/MEDEF introduced specific voluntary targets for women in boards not only in CAC 40 companies but also in other listed companies. In just one year after its adoption the number of women in boards increased from 10% to 15.3%.

- In the UK, Denmark and Austria, companies have designed specific initiatives aimed at training women to be "board-ready".

- In Germany, the Corporate Governance Code requires companies to aim for an appropriate consideration of women in the management board. For the supervisory board, companies shall specify concrete objectives. These provisions have led to a significant increase of women:

  - In supervisory boards of Germany's largest publicly listed companies (DAX-30), the number of women among the members elected by the shareholders has more than doubled.

  - Regarding the entire supervisory boards of these companies (including the members elected by the employees), the percentage is now 15.4.

  Furthermore, DAX-30 companies have submitted the declaration "Women in executive positions", aimed at increasing the number of women in staff and especially in executive positions.

These and other initiatives are encouraged by BUSINESSEUROPE and disseminated widely as examples of best practices that should be followed in other Member States.

Question (7) - Do you believe there should be a measure at EU level limiting the number of mandates a non-executive director may hold?

It must be stressed that any EU initiative must respect the shareholders' right to designate the board members they deem best to enable the success of the company. The green paper points to several circumstances which have to be taken into account when considering whether a non-executive director has sufficient time to attend to his or her duties as a board member. These circumstances differ from company to company and from director to director.

Putting a limit to the number of mandates a non-executive director may hold is not the right solution as it does not address all these different circumstances appropriately.

BUSINESSEUROPE does not support a measure at EU level limiting the number of mandates.

In addition, a limitation of the number of directors' mandates would be complicated: whether (or not) the director has an executive role, sits in one or more board committees, sits in boards of directors of companies in the same group, or whether it is a listed or non-listed company. This is why this matter should be left to corporate governance codes which allow the necessary flexibility.

What is key is directors' availability and time commitment. This is sufficiently addressed by paragraph 12 of the Commission Recommendation 2005/162/EC on the role of non-executive or supervisory directors of listed companies which has been transposed into national corporate governance codes.

Question (8) - Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)?

BUSINESSEUROPE believes that it is important that listed companies regularly evaluate the work of the board of directors. Its purpose should be to ensure the well-functioning of the board. This is not necessarily achieved by requiring an external assessor to carry out the evaluation. Mechanisms of professional evaluation, used in a number of Member States, could work as a best practice in this regard.

Added value seems much more likely if the board has a share in the evaluation, with the chairman of the board playing a central role. It seems suitable that the chairman is responsible for ensuring that such a process of evaluation is accomplished regularly. The chairman is the person who best knows how the work of the board has functioned and should therefore have the central role in the evaluation.

BUSINESSEUROPE believes that the evaluation of the functioning of the board is a corporate governance code issue and need not be addressed at EU level. This would only bring more costs for companies.

Questions (9) and (10) - Should disclosure of remuneration policy, the annual remuneration report (a report on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors be mandatory? Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?

BUSINESSEUROPE acknowledges the importance for a company's reputation that remuneration levels of its executives are legitimate, perceived as reasonable and justified in the light of: the level of responsibility of executives, the company's strategic development and the company's results.

Remuneration policy should also be aligned with long-term objectives and avoid reward for failure.

For BUSINESSEUROPE, one of the main issues at stake is a transparent remuneration policy and a clear relationship between a company's performance and the remuneration of people responsible for that performance.

Businesses have a key role to play in this debate through adoption of transparent procedures and by complying with corporate governance codes. Therefore, the emphasis should be shifted from more regulation to better monitoring and effective application of legislation or corporate governance codes. The Commission's 2009 recommendations on remuneration are gradually being implemented by Member States and companies.

The absence of vote on remuneration policy does not mean that shareholders are deprived from expressing their point of view. Shareholders are granted numerous rights, reinforced by the Directive 2007/36/EC of 11 July 2007 on the exercise of certain rights of shareholders in listed companies: shareholders have the right to put items on the agenda of the general meeting and to ask questions related to items on the agenda of the general meeting. As a consequence, they can debate directors' compensation. Moreover, the board has to answer for directors' compensation and shareholders always may decide to appoint a new board if they disagree with the remuneration policy decided by the board.

A remuneration policy should be formulated so that it drives the behavior of senior executives according to the shareholders' objectives. However, it may be technically difficult to construct such systems and to find the right balance between the different elements of the remuneration. This is why a vote on individual compensation would be impossible to put in practice: for example what would happen if shareholders agree with only some of the various elements of the remuneration?

Therefore, BUSINESSEUROPE believes that more time should be given to properly assess the effectiveness of existing legislation, recommendations and best practices before adopting new legislation in this area.

BUSINESSEUROPE is of the firm opinion that remuneration issues are best tackled within the framework of professional regulation and transparency.

Questions (11) and (12) – Do you agree that the board should approve and take responsibility for the company's 'risk appetite' and report it meaningfully to shareholders? Do you agree that the board should ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile?

BUSINESSEUROPE agrees that risk management is a core assignment for executive and non-executive directors. It also agrees that the board should determine the company's risk appetite and ensure that the company's risk management is effective and commensurate with the company's risk profile.

It is crucial that executive directors and the supervisory board (non-executive) are continuously aware of issues relevant for the company's risk profile and risk management.

It is up to the management to manage and address the risk and for the board to supervise it. This should be done taking into account the individual company's activities, strategy and objectives.

BUSINESSEUROPE also does not see the need for additional reporting to the shareholders in respect of risk management. Companies already have in place several safeguards when it comes to assessing and tackling risk, one of them being internal auditing whose importance should not be underestimated.

2. Shareholders

Institutional shareholder engagement (Questions 14, 15 and 17)

How to encourage active ownership is an important debate. It is linked to the fact that shareholders are not only bearers of rights but also duties.

Transparency on corporate governance issues is important in order to enable shareholders to conduct their ownership and fulfil their duties: ask questions at the annual general meeting, make demands and contribute to the company's value creation.

However, introducing further EU regulation aimed at companies (hard law) does not seem the best way to address possible shortcomings related to lack of active ownership.

Corporate governance codes are aimed at companies (not shareholders) and should call on companies to promote active ownership. In this regard, transparency is very important. Beyond that, companies cannot do much to "force" shareholders to conduct active ownership. Hence imposing prescriptive rules at EU level on companies will not necessarily lead to active ownership. Instead, it will add administrative burdens.

For these reasons, BUSINESSEUROPE believes this topic should be left to corporate governance rules at national level rather than prescriptive rules at EU level.

BUSINESSEUROPE acknowledges that the role of institutional investors is fundamental to develop good practices in corporate governance. It is important that they disclose their voting practices and policies. In order to solve the lack of engagement by institutional investors, a duty to adhere to a national code of best practices including a principle of 'comply or explain' could be envisaged.

Proxy advisors (Questions 18 and 19)

BUSINESSEUROPE recognises the challenges presented by the increasing delegation of voting power to proxy advisors, including conflicts of interests, separation of voting power and control (agency problem) and the effect of leading companies into a one-size-fits-all approach to governance. Accordingly, BUSINESSEUROPE would welcome further study and potential guidance on the internal governance of proxy advisors and how their voting recommendations are developed and implemented.

Shareholder identification (Question 20)

BUSINESSEUROPE agrees that it is important for a company to be able to identify its shareholders. It can help improving company-shareholder engagement hence reducing the risk of abuse connected to 'empty voting'. It can also help creating the basis for real dialogue between real investors/shareholders and the issuer.

However, EU intervention in this area should not occur without a proper impact assessment. Identification of shareholders should be considered as a right for companies rather than an obligation. In addition, such a system should not impose unnecessary costs on companies.

Minority shareholders (Questions 21 and 22)

The EU should not intervene further in this area. There are already sufficient mechanisms at EU level (e.g. shareholders' rights directive) protecting minority shareholders which are reinforced by national legislation.

Employee share ownership (Question 23)

For BUSINESSEUROPE, employee share ownership is not an issue that should be addressed at EU level.

3. The 'comply or explain' framework

Question 24 - Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?

The Green Paper notes both that the principle of 'comply or explain' (which applies to a number of corporate governance codes) is "widely supported by regulators, companies and investors" (pag. 18), and that in respect of the stated explanations "a slow but gradual improvement in this field can already be observed" (pag. 19).

Solutions based on 'hard law' should be kept to a minimum and only for those aspects for which professional regulation cannot provide satisfactory results. In this fast-moving area, corporate governance codes are the best means of promoting the right corporate behaviour. They are flexible, easy to implement and update and allow for deviations (with explanations).

BUSINESSEUROPE agrees that the 'comply or explain' principle should be strictly applied and that whenever a company departs from a provision of a code, it should explain why and, if it is the case, include particulars of the alternative solution chosen.

Corporate governance codes are right to focus on the need for an explanation of any non-compliance, rather than require disclosure of alternative solutions although, as indicated, these will often be included in explanations.

Question 25 - Do you agree that monitoring bodies should be authorised to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If yes, what exactly should be their role?

BUSINESSEUROPE agrees that more focus should be put in the monitoring of implementation of corporate governance codes.

BUSINESSEUROPE firmly believes that it is up to shareholders to evaluate the quality of explanations of corporate governance statements and to signal lack of clarity or inconsistencies. Shareholders can always vote against certain practices if they consider they lack proper information.

Encouraging effective engagement by shareholders, as part of their regular engagement process with the company and its board, provides a precious help. It improves the quality and usefulness of companies' corporate governance statements without the need for significant additional regulatory intervention.

In certain Member States there are already mechanisms of monitoring in place either by professional organisation or national authorities. The EU should avoid imposing a specific mechanism to analyse companies' corporate governance statements and explanations.

Such a mechanism might be very costly, time-consuming and bureaucratic, especially if public authorities become involved. This would also be against the aim of existing recommendations (e.g. on remuneration) and risk becoming counter-productive.

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