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Confédération Européenne des Associations d'Administrateurs
European Confederation of Directors' Associations

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ecoDa's response to the EU Green Paper on CG for listed companies

ecoDa welcomes the initiative taken by the Commission to gather stakeholders' views on the Corporate Governance of listed companies.

Our response reflects the opinions of European board members associations.

As a result of this consultation, ecoDa hopes that the European Commission will find the right balance between self-regulation and hard law with the aim of fostering the long term sustainability of the European economy and society at large, and not resort to overkill in regulatory terms which would be detrimental to entrepreneurship and innovation across the European Single Market.

The general questions, raised by the Green Paper

As a preliminary remark, ecoDa would like to stress that even if board members are nominated by shareholders and should therefore act in the interests of all shareholders and treat them equally, they should also take the interests of all relevant stakeholders into consideration when making board decisions. It is obvious that a "limited shareholder focus" is outdated. ecoDa indeed agrees with the position taken in the Green Paper that corporate governance as well as corporate social responsibility are key elements in building people's trust and in improving the sustainable competitiveness of the European business world. However, it is not advisable that the Commission treats those themes totally separately. The Green paper on corporate governance refers to the EC's public consultation on non-financial information and its ambition to develop a new framework initiative related to the social challenges enterprises are facing. In order to develop sustainable growth, ecoDa would like to propose embedding the corporate responsibility agenda into the governance framework.

In this respect, ecoDa wishes to stress that corporate social responsibility is ultimately a key aspect of the board's fiduciary duty towards the company. Enhancing the ultimate purpose of a company – to sustainably generate profits for its shareholders - requires a profound understanding of the interests of all stakeholders who take an interest in the company and its operations.

QUESTION 1: Should EU corporate governance measures take into account *the size* of listed companies? How? Should a differentiated and proportionate regime for small and medium-sized listed companies be established? If so, are there any appropriate definitions or thresholds? If so, please suggest ways of adapting them for SMEs where appropriate when answering the questions below.

ecoDa promotes proportionality and not a one-size-fits-all approach. Therefore ecoDa is pleased with the approach developed by the Green Paper: to *substantially differentiate between different categories of listed companies*:

- As to the necessary measures to stimulate effective governance, the Commission VERY CORRECTLY recognizes that different shareholding structures raise different issues (such as passive shareholders versus issues like minority protection).

- However, generally speaking, the European rules on corporate governance do not distinguish according to company size or type. Therefore we plead for a more nuanced approach. What could be important differentiators to define the most effective governance framework?

- Size matters as much across member states as within each of the EU countries. ecoDa suggests to not only focus on absolute size indicators but to also take the different categories of indices into account as a possible measure of size per country. The Monitoring study on the Comply or Explain Principle (2009) has reflected on the differences between companies belonging to different indices. The speed and depth of application of governance recommendations are clearly different.

- Although company size is important, SHAREHOLDING STRUCTURES CONSTITUTE THE MOST IMPORTANT FACTOR TO EXPLAIN THE DIFFERENT NEEDS IN GOVERNANCE TERMS:

- Insiders (block holding) offer a more active monitoring framework but pose also specific challenges for the protection of minority shareholders (the danger of abusing a controlling position to gain private benefits).

- Shareholding typology leads to different time horizons: some are traders with a very short time horizon (e.g. day traders); others are investors interested in liquidity because their time horizon is relatively short (on average less than a year), whereas others are there for the long(er) term if not for generations.

ecoDa believes that the EU should give more attention to the flexibility offered by the comply or explain regime. Best practices have often been defined by reference to the larger blue chip companies. Those 'standards' are less adapted to the companies in the micro/small and even mid-cap markets, let alone the non-regulated segments of the capital markets. Best fit should be the ultimate objective, and not universal adoption of standard best practice for large companies. Research into what constitutes VALID explanations and ALTERNATIVES might be very useful for those market segments.

Question 2: Should any corporate governance measures be taken at EU level for unlisted companies? Should the EU focus on promoting development and application of voluntary codes for non-listed companies?

With respect to unlisted companies, the Commission should not take measures through legislation. ecoDa encourages the European Commission to stimulate a voluntary approach for promoting good governance for unlisted companies. However the underlying rationale of such best practice should be different to the one used for listed companies.

In contrast to listed companies, where the incentive for governance comes from external pressure and is compliance-focused, governance in unlisted companies has to be stimulated from within and should much more build upon the true value-drivers of governance, such as fostering:

- continuity (over the generations),
- growth (opening towards external funding and new shareholders) and
- professionalism (checks & balances, objective decision-making rules, focus on the interest of the company, etc).

In non listed companies, shareholders are the key driver for implementing good governance; therefore the shareholders should clearly see the benefits for the company and for themselves. Moreover, the great diversity within the universe of unlisted companies necessitates a phased approach to governance (rather than one size fits all), tailored to the development phase of the company, as promoted by ecoDa (http://www.ecoda.org/AnnualConference2010.html).

The impressive number of translations into national governance environments and national languages across Europe of these recent ecoDa recommendations (see Table below) proves that there is a great need for such recommendations. An EU-wide recognition of this need would foster further application and would accommodate the growth path of this very important segment of companies. However, the best placed actors to develop and promote company guidance of this kind are national institutes of directors. The Commission should therefore encourage the creation of national institutes of directors in those EU countries where they currently do not exist (approximately half of the EU member states).

National adaptations of ecoDa CG Guidance and Principles for Unlisted Companies in Europe (State of play – April 2011):

UK: IoD organised an event on 22 November 2010 and issued a British tailored version.
Poland: The publication was translated into Polish by the Polish institute of directors.
Baltic countries: The Baltic Institute of Corporate Governance is about to develop and adapt ecoDa Guidance for the 3 Baltic states in a similar manner to the IoD.
Hungary: The Corporate Governance & Business Integrity Committee of the American Chamber of Commerce in Hungary has translated the publication into Hungarian and has organized an event in December 2010 including ecoDa's participation.
Denmark: The Danish Institute for Corporate Governance (an executive network for 1700 of the most influential top executives and board members in Denmark) has requested the right to adapt the guidelines for unlisted companies in Denmark.
France: The French IFA is working with KPMG on a French translation.
Finland: Hallitusammattilaiset has just finalized a translation into Finnish.
Italy: The Italian institute NedCommunity inserted an executive summary of ecoDa's book in their newsletter named "La Voce degli Indipendenti". They made a presentation of the ecoDa Guidance in September 2010, during a meeting which was organized in cooperation with the Association of Family Enterprises.
Albania: The Global Corporate Governance Forum is working on an Albanian version of the guidance.

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Spain: the Spanish association of board directors, Instituto de Consejeros-Administradores, has launched (in 2005) a similar initiative that perfectly fits with the ecoDa European version.
Belgium: the Commission Buysse has redrafted the 2004 version of the Code for unlisted companies along the same lines of thinking as the ecoDa phased approach.

Set of questions on boards of directors

The role of the board of directors certainly involves challenging executive management and undertaking risk oversight (p3). However, this Green Paper mainly refers to the supervisory role of directors (p5). ecoDa wishes to remind the Commission *not to neglect or forget the important role the board also plays with regard to leadership and strategy!*

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?

Taking into consideration the huge diversity in board and management models across Europe, ecoDa considers it unrealistic to legislate for a 'one size fits all' approach to the respective roles of the chairman of the board and the CEO. However, given the important role a chairman of the board plays in fostering and monitoring good governance, effective board behaviour and board dynamics, ecoDa wants to stress that each board has the duty to develop a detailed description of these respective roles. In describing these two roles, the board should take into consideration the following principles:

- In a company with an effective governance and management, no individual should have unrestricted decision-making powers. The exercise of such powers should be subject to control.
- A starting point for the delineation of responsibilities could be based on the division of work between the board and the executive management (led by the CEO). Accordingly, the chairman of the board should, as a rule, not interfere in the day-to-day business of the company.
- If the Chairman of the board is an executive, there should be a lead independent director who can play a leading role if a conflict-of-interest situation emerges while also acting as a countervailing power vis-à-vis the executive chairman.

Board Composition

Question 4: Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how could that be best achieved and at what level of governance, i.e. at national, EU or international level?

It is in the best interest of companies to have an effective and well-performing board. It should be kept in mind that boards are evolving entities, and therefore the board's profile should be updated at regular intervals.

In order to achieve the goal of a well-performing and effective board, *board composition and director assessment should gain extra attention*, certainly when it comes to defining the *most suitable set of selection criteria*. Indeed board composition should be tailored to the specific circumstances of the company, its challenges, strategic ambition and time constraints. Therefore it is doubtful that general recipes can be developed. Case by case tailoring should be the rule.

The EU correctly points to the merit of diversity in board composition (such as a wider pool, tackling group-think, generating new ideas and finally better decisions). However, the EU should abstain from defining board profiles and should limit itself to stimulating a professional selection combined with sufficient transparency and accountability towards shareholders and other relevant stakeholders.

In addition and as a general principle sufficient attention should also be paid to a professional board support process. Especially for non-executive directors, it is important to invest sufficient time and money in the induction of new directors and into the continuous development of the skills of board members. To this end, institutes of directors are best placed to provide exchanges of good practices. Furthermore, ecoDa wants to stress the importance of investing corporate resources in the training and development of directors and hopes that the European Commission will consider certification of directors as a next step in the process of professionalization of governance in general and board of directors more specifically.

Effective boards will ensure that individual directors invest time and effort in sufficiently understanding the business and the challenges and risks it faces. As a general principal for board decision-making and directors' voting practices, a director should "not approve any matter without understanding and awareness of the consequences or without being in full agreement".

Question 5: Should listed companies be required to disclose whether they have a diversity policy and, if so, describe its objectives and main content and regularly report on progress?

Taking into consideration the difficulties involved in establishing community wide prescriptions on diversity policy, mandatory disclosure of the corporate diversity policy, its objectives and progress, could be the best solution. However, ecoDa would like to point out that the disclosure requirements should be carefully considered so as not to result in a further "boilerplate" disclosure practice. At the same time, ecoDa would like to emphasize that such diversity policy is not limited to the gender balance of the board of directors but that diversity is approached in its wider context (see question 6).

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

For several reasons, ecoDa doesn't see a need for regulatory intervention on board gender balance, at EU level,

- *Numerous initiatives are already taken at national level*, each trying to tailor the measures to the local business environment and societal norms. Corporate Governance is evolving in a political context and different countries have different political contexts.

- Moreover, ecoDa wants to make reference to its response to the EU Green Paper on CG for financial institutions, *pleading that corporate governance policy is not used to promote a wider political agenda*.

- However ecoDa wants to promote a *mandatory disclosure*, as described in question 5, which better serves the intention to reach a 'tailored' gender policy.

- Although gender diversity at board level has gained much attention, this is *only a limited part of the more general issue of gender equality* within the business world. As stated in the Green Paper, it is important that companies adopt a broader diversity policy. If the EU wants to foster such broader equality issues, it should not forget to define more general policy recommendations to promote greater inroads into business management for women, equal career opportunities and supporting policies (such as work-life balance issues, flexibility, child care, etc).

- The EU Commission correctly pointed to the fact that *mentoring, networking and adequate training* for management and board positions are essential for women (as well as men!) wanting to follow a career path that leads to eligibility for board positions. *Director Institutes* could become important partners for the transition towards professional directorships.

In addition, to promote gender diversity within boardrooms, initiatives to favour women's accession to executives' positions should be encouraged.

Availability and time commitment

(7) Do you believe there should be a measure at EU level, limiting the number of mandates a non-executive director may hold? If so, how should it be formulated?

(See also previous ecoDa reaction)

This question should be considered in the context of the total framework of time invested by an individual in other executive and non-executive functions, in listed and unlisted companies and other social profit organizations. Numerical *limitations are too complex to define on a national, let alone a supra-national level* (with different board models and quite different types of listed companies).

Notwithstanding this observation, *availability and time commitment are crucial for board effectiveness, but such engagement can best be judged on a case by case basis*. Requiring

periodic (externally supported) board and director evaluations is the best way of achieving a systematic and critical judgement on availability and commitment in a given setting. Moreover, on the basis of the existing disclosure requirements, detailed CV information and attendance records (in listed companies) can already be judged prior to the nomination.

The *letter of nomination* of Non Executive Board Members should point out the need for the director to be available and to dedicate sufficient time. Such a letter should also state the importance of a constructively challenging role in the development of strategy while at the same time fulfilling a rigorous monitoring role vis-à-vis management and the company.

The Green Paper correctly points to the fact that the role of non-executive directors has grown in complexity and importance, leading to a considerable increase in time to be invested in a board mandate in a listed company. However, one should not forget that time has its price and that higher availability and time commitment should be compensated by a higher remuneration. The structure of remuneration for non-executive directors should however be different from that of the executives (to install sufficient checks and balances and a countervailing focus on the long term success of the firm).

Board evaluation

(8) Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)? If so, how could this be done?

Evaluation of board effectiveness is an essential ingredient of good corporate governance and is the only feasible alternative for monitoring qualitative governance performance (in respect of which external transparency is typically not a viable solution).

This does not imply that all governance elements should be evaluated annually (as is defined in the European Recommendation of 2005); on the contrary, such a recommendation would lead to overkill and inefficiencies. The periodicity and content of general board evaluations will depend on the governance challenges the company is facing (with more frequent evaluation if specific challenges have to be confronted, e.g. such as an important reshuffling of the board's composition after a merger, when special tensions pop up within the board or between executives and non-executives).

Individual director assessment is essential *every time a mandate is up for renewal*.

As to the question whether such evaluations should be *externally conducted or supported*, a nuanced answer is necessary. On the one hand, an externally supported approach certainly has its advantages, such as a greater guarantee of confidential evaluations, also including the functioning of the chairman, more objective reporting, etc. However such an externally supported approach may also have its drawbacks, e.g. its cost, its quality, etc. But more attention for externally supported evaluations will undoubtedly drive more supply from external evaluators, competition and hence quality

ecoDa fully agrees with the EU Commission that any disclosure on board evaluations should be limited to explaining the evaluation process. The European Commission should not be prescriptive on how the evaluations should be carried out. This is not a beneficial route for it to take.

Director remuneration

As already pointed out in ecoDa's reaction to the Green Paper on financial institutions, the EU Commission continues to insufficiently distinguish between executive remuneration and remuneration for (non-executive) board membership. ecoDa wants to stress the need to clearly distinguish the remuneration of the board of directors and that of executives (either executive directors or not). This is all the more important since both types of remuneration are completely different in nature and (should) answer to quite different criteria and hence remuneration structures in order to be effective.

Question 9 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?

As far as the board's remuneration policy is concerned, shareholders should be provided with more legal rights on the board's remuneration approval procedure and transparency. For ecoDa this principle means that the general shareholders' meeting should always *approve the remuneration of board members, since the shareholders are the monitors of the board of directors*. This principle for board directors' remuneration policy combined with clear transparency is an essential element to be taken into consideration. In that sense, ecoDa would welcome any new EU initiatives to foster such transparency standards.

At the same time, regarding executive remuneration, and taking into consideration the remarks to question 10, this is primarily a matter for the board's final approval since the board of directors is responsible for monitoring the management. However, the debate on executive remuneration has been at the forefront in many Member Countries, not least because of the social aspects related to the level and structure of such remuneration, including the issue of pay for non-performance (such as golden parachutes, absence of good correlation with firm performance, etc.)

Numerous Member States already have introduced mandatory requirements on disclosure. Although such transparency may lead to growing populist discussions in the media, it may also lead to better social accountability. If supported with a standard reference framework (such as is the case in Belgium and in France), these requirements can facilitate the completeness, comparability and hence relevance of such disclosure. *It would therefore be beneficial if the EU would foster such transparency standards in those Member States where they are currently lacking.*

(10) Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?

As highlighted in the previous question, the shareholders have a crucial role to play in deciding on the remuneration of the board of directors. A totally different issue is the role shareholders have to play as to the remuneration of executives (executive directors or the board of management). It is indeed a challenge to find a solution that at the one hand fosters accountability while at the other hand is effective and does not transpose the role of the board to the shareholders' meeting. Although it is important to maintain transparency and inform the shareholders on the execution of the remuneration policy (see answer to previous question), a mandatory shareholders' vote on the contents of the remuneration report (except when remuneration is based on shares or share derivatives), could interfere in a matter which clearly belongs to the board.

Risk Management

Question 11: Do you agree that the board should approve and take responsibility for the company's 'risk appetite' and report it meaningfully to shareholders? Should these disclosure arrangements also include relevant key societal risks?

Question 12: 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?

ecoDa agrees with the analysis in the Green Paper, that it is not possible to develop a European wide approach towards risk management, but that it is critical that the board ensures proper oversight of the risk management process. This implies defining (from the top) the risk profile according to the strategy followed and monitoring risk management and internal control adequately to ensure it works effectively, as well as reporting meaningfully to the shareholders on an annual basis.

On the specific question of the contents of the disclosure, ecoDa is of the opinion that such disclosure could benefit from a broad based reference framework, including attention for financial as well as non-financial risks (see e.g. the scheme developed in Belgium in a joint venture between the Corporate Governance Commission (on listed companies) and the Institute of External Auditors).

Set of questions on shareholders

ecoDa agrees with the statement that the European corporate governance framework is built on the assumption that shareholders engage with companies and hold the management (the board?) to account for its performance (p2). However there is evidence that the majority of shareholders are passive and often only focused on short-term profits, at least when it comes to listed companies with dispersed ownership. In companies with a dominant or controlling shareholder, this seems to be less of a problem, but also this model faces governance challenges, be it of a different nature: here the major challenge is to ensure that the (economic) interests of minority shareholders are adequately protected. *These observations in respect of differing ownership structures clearly demonstrate that one size does not fit all when it comes to designing adequate governance mechanisms.*

Short-termism is a specific challenge in countries where listed companies mostly have dispersed shareholding. In contrast, short-term share trading, higher turnover velocity and liquidity are seen as necessary to create an active capital market in those countries where controlling shareholding is the norm.

Lack of appropriate shareholder engagement

For ecoDa, shareholders have to fulfil their role as owners of the company and monitor the value of their assets by taking a regular interest in the life of the company and its strategy. Shareholders should be reminded that if they have rights, they also have duties too. Better fulfilment of shareholders' duties will improve the whole corporate governance process for the benefit of all stakeholders. By taking part in the general meetings, exercising their right to vote, and disclosing their voting policy, the shareholders demonstrate their involvement in key issues of the company. Part of institutional shareholders' duties is also to be transparent and accountable for their actions as owners of companies. Institutional investors should vote in a responsible manner, above all when they plan to vote against a resolution of the General Meeting.

Regular dialogue between professional investors and the company's leaders should also be encouraged not only at the time of the general meeting, but also in the course of the year. The company has to identify the respective duties of management and the board in this respect. More and more, shareholders expect the non executive chairman of the board and possibly also independent directors to discuss the strategy, the remuneration policy and the major issues with shareholders.

ecoDa agrees with the EU Commission that primarily long-term investors (true holders of shares) have an interest in active engagement (defined as actively monitoring companies, engaging in dialogue and using shareholder rights). Although points 2.3 through 2.6 look at the problem of the lack of engagement of institutional shareholders and methods to curb this inactivity, a more overall analysis is lacking. It would be interesting to further analyse the shareholding structure and typology throughout Europe and detect what systems deliver what type of monitoring and to what extent they really foster long-term sustainability. This Green Paper falls short of such general analysis and mainly focuses on methods to make institutional investors more active monitors.

An additional point of attention in this respect might be that the definition of institutional investors in its broadest sense (footnote 47, p 11) may be misleading in so far as it integrates private equity with true institutional investors (such as pension funds, investment funds and insurance companies). In contrast to these pure institutional investors who often do not actively engage with the companies they invest in, the private equity business model is totally different: its value added is based on a very active monitoring of the investee companies.

Short-termism of capital markets

Question 13: Please point to any existing EU legal rules which, in your view, may contribute to inappropriate short-termism among investors and suggest how these rules could be changed to prevent such behaviour.

ecoDa supports the Green Paper's observation on this topic, pointing to the potential drawbacks of the business model of modern 'commercial' capital markets. The efficient operation and profitability of stock exchanges is a crucial driver, since they are commercial organisations, often themselves being listed companies. Although listing income is instrumental for their functioning, the bulk of their business income stems from the trading function. Consequently, high frequency and automated trading and sufficient liquidity are of primary importance. This transaction-based business model clearly helps to promote shorter shareholding periods (to approximately 8 months on average). Therefore, ecoDa agrees that much more attention should be paid to the 'unintended' consequences of this business model.

Also special attention should be paid to the impact of IFRS rules. IFRS focuses on transparency and market value as guiding valuation methodologies. Consequently, market cycles and boom and bust pricing directly affect the valuation of corporate and financial assets. As such, market value may significantly deviate from underlying intrinsic value. It may create an indication of wealth creation, capital gains and income which are not more than short-term 'paper gains'. If these income indicators are used as the reference base for the distribution of profits and executive remuneration, a dangerous future looms on the horizon for the continuity of the company, certainly when the cycle reverses. This observation holds all the more for long term investors, such as pension funds and insurance companies. Further investigation on how to curb this challenge seems more than valuable to ecoDa.

The agency relationship between institutional investors and asset managers

Although many contractual engagements of institutional investors have a long-term time horizon, the Green Paper correctly points to the fact that the average investment horizon has been drastically decreasing over the last decades. Notwithstanding the fact that the Commission recognizes that investors are free to choose their investment horizon and investment attitude, the Green Paper approaches the issue of short termism from an useful perspective by researching all possible explanations for such choice.

Question 14: Are there measures to be taken, and if so, which ones, as regards the incentive structures for and performance evaluation of asset managers managing long-term institutional investors' portfolios?

It is clear that this question is aligned, at least in part, with the question on the business model of the stock exchange. If the business model fosters share trading and remunerates in line with short term performance, the system will promote volatility and short termism.

Although ecoDa is not in the possession of relevant statistics that prove the causality between incentive structure and the time horizon of asset managers, it is a very valid question. The general discussion on performance related pay has indeed raised a number of challenges concerning the alignment of the time horizon of variable remuneration with the drive to promote long-term sustainability.

Before considering any possible measure to curb short termism of asset managers, a more in-depth research of this potential causality is necessary not only for asset managers but also for the commercial stock exchanges.

Question 15: Should EU law promote more effective monitoring of asset managers by institutional investors with regard to strategies, costs, trading and the extent to which asset managers engage with the investee companies? If so, how?

This question supposes that institutional investors are interested in active monitoring. ecoDa would like to challenge this assumption. To what extend is investors' need for diversity, risk spreading and liquidity compatible with the assumption that they will, of their own volition, become the (governance) monitors of the companies they invest in? More attention should be paid to the diversity between institutional investors in each of the Member States, but especially throughout the EU. Some are only *following the index* and consequently any additional investment in monitoring is of no use. Others *pick and choose* their equity portfolio but given the need for risk spreading, only invest *small percentages in a vast number of international companies.* Such vast bulk of investments cannot be monitored efficiently since the costs would outweigh the surplus income this could generate (free riding principle). It is only when investments become *more substantial*, or when the investment policy is of *the 'activist' type,* that such institutions (can) become active monitors of corporate governance.

Other possible obstacles to engagement by institutional investors

Question 16: Should EU rules require a certain independence of the asset managers' governing body, for example from its parent company, or are other (legislative) measures needed to enhance disclosure and management of conflicts of interest?

As in any case of potential conflict of interest, special attention should be paid to mechanisms to either prevent and/or manage conflicts of interest. Moreover the assumption that institutional investors attach great importance to governance monitoring by their asset managers is open for further reflection and discussion.

Moreover, any governance transparency that they demand from the company should be demanded from them too. The Commission can no longer ignore to pay insufficient attention to the governance of institutional investors. Transparency and accountability of institutional investors are relevant for all parties involved (clients, investors as well as investee companies and other capital market parties). Moreover, it might be important to require independent directors to represent the interests of the ultimate beneficiaries and to check the efficiency of remuneration arrangements.

Question 17: What would be the best way for the EU to facilitate shareholder cooperation?

The European Commission is assuming that institutional investors want to cooperate and seem to forget that they are often competing with each other, which in itself may constitute an obstacle for cooperation.

It is clear that one of the reasons for the inactive attitude of institutional investors can be the cost/benefit picture attached to such interventions. Two main problems that have gained (academic) attention in this respect are the free riding problem (investors with small investment percentages have little incentive to expend cost and effort on governance as passive investors in the company will also benefit from their efforts at zero cost and hence outperform the active ones) and the collective action problem (it is difficult to find a way for competing investors to collaborate in order to gain sufficient influence over a company in which they both have shareholdings). These problems are typical for such widely dispersed shareholders. Moreover there is a strict EU regulation for 'acting in concert' (with the potential consequence to make an obligatory take-over bid above a 30% threshold of ownership). The European Commission should clarify the legal situation/constraints in each national jurisdiction as shareholders are sometimes using this legal issue as an excuse not to cooperate.

Given these observations, the Green Paper correctly points to the need for facilitating such cooperation. An important leverage factor could possibly be found in a more independent position and role of proxy advisors (see next point). However, one must not forget that more active investor monitoring must also be combined with a longer term time horizon. Such cooperation mechanisms will probably not imply that the time horizon will be drastically shifted.

Proxy advisors

Question 18: Should EU law require proxy advisors to be more transparent, e.g. about their analytical methods, conflicts of interest and their policy for managing them and/or whether they apply a code of conduct? If so, how can this best be achieved?

The voting rights attached to the dispersed portfolio of institutional investors are in practice mostly channelled through proxy advisors. As such, proxy advisers can play an important role in optimizing the monitoring role of such investors in a more cost-efficient way. Given the pivotal role such intermediaries could play in professionally analysing and advising on governance quality, ecoDa would welcome that the Commission further investigates routes to a more transparent monitoring role as well as a more efficient collaboration with and between institutional shareholders.
The methodology they use should be publicly available and be tailored to the national governance environments and even the type of corporation at hand (and not be a one size fits all approach, based on the dominant firm logic of the US market, which is often irrelevant for many continental European companies).

It appears that some of the proxy advisors develop a box ticking approach and are inclined to use the same standards everywhere. If proxy advisors want to be part of good governance, they should provide the same related rules and be accountable on the quality of methodology as well as on how they advise. They should also work to eliminate conflicts of interests.

Question 19: Do you believe that other (legislative) measures are necessary, e.g. restrictions on the ability of proxy advisors to provide consulting services to investee companies?

Given the potential role proxy advisors could play, it should even be questioned whether such organisations should be allowed to offer any other services to the companies on which they advise and limit their services to activities on behalf of institutional investors.

Shareholder identification

Question 20: Do you see a need for a technical and/or legal European mechanism to help issuers identify their shareholders in order to facilitate dialogue on corporate governance issues? If so, do you believe this would also benefit cooperation between investors? Please provide details (e.g. objective(s) pursued, preferred instrument, frequency, level of detail and cost allocation).

The issue of shareholder identification is a rather complex challenge in several respects. Such information is crucial for the development of a dialogue between the firm and its shareholders. While identification might be evident for long term shareholders, such identification entails a number of problems when it comes to more volatile shareholders. The higher the share volatility, the less efficient shareholder identification becomes. However,

corporate leaders (directors and managers) will always be interested in understanding the shareholding structure and its evolution because important changes might send very relevant signals as to the approval or disapproval of the corporate strategy and corporate performance. Significant changes can signal that a shift of strategy or even a take-over might be in the pipeline. As to the exercise of shareholder rights, it is necessary that such identification becomes efficiently realisable for organising shareholder meetings. However one should also look at the cost-benefit side when it comes to very small shareholders. Here registration should be the least burdensome possible.

Minority shareholder protection

Question 21: Do you think that minority shareholders need additional rights to represent their interests effectively in companies with controlling or dominant shareholders?

It is clear that each governance model has its advantages and disadvantages. Whereas dispersed shareholding suffers from passive or no monitoring and rather short-term time horizons, the controlling shareholder model is a far better monitor. This has been scientifically proven in the case of executive remuneration (PhD under supervision of Prof. Lutgart Van den Berghe). However this insider model (where controlling shareholders are also board members) leads to the danger of abuse of power and the extraction of private benefits at the detriment of minority shareholders. In such models, the legislator often already pays special attention to the protection of minority rights. Where this is not the case yet, extra mandatory rules might be necessary;

However, the European scenery is quite diverse in respect of the need for further development of minority shareholder protection. Consequently, ecoDa makes a plea to first investigate the different needs of each Member State. In some countries minority protection is already very well developed. Other countries are still searching for methods to foster a more active capital market and mechanisms to promote more widely-held shareholdings, whereas other markets are in search of more long term oriented block holders.

Mechanisms ensuring that independent directors play a key role in focusing the board's attention to a fair treatment of all shareholders (as well as all relevant stakeholders) deserve further reflection. As stated by the Green Paper, the Italian example of special nomination rights for minority shareholders is an interesting example. But more community wide research might reveal many other examples. An interesting case in this respect can be found in Belgium with Belgacom, a state-controlled listed company, Here the non-controlling investors (having less than 50% of the shares) get the right to nominate half of the directors, all being independent directors. Combined with the majority of the nomination, remuneration and audit committee being independent, this gives the outside minority a more than balanced position.

Question 22: Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?

Minority rights and related party transactions are important topics of attention, but the challenges posed by related parties go far beyond minority protection. Therefore this topic should gain more prominent attention at EU level. The Commission could possibly await the outcome of the recent OECD initiatives in this respect. Indeed, the OECD has been conducting in-depth research in this governance challenge and will further investigate detailed national regulations and recommendations that should inspire the development of solutions curbing this problem.

Any transaction between shareholders or between a company and its shareholders, directors or managers should take into account the interests of all other shareholders. Companies should indeed foster the interests of all shareholders if they wish to be sustainable companies in the long term.

Independent directors exist to represent the interests of the company in general and of all its shareholders in particular. In countries with controlling shareholding, independent directors have a special role to play in this respect. Independent directors should be trained to better understand this important role.

Employee share ownership

Question 23: Are there measures to be taken, and is so, which ones, to promote at EU level employee share ownership?

In certain Member States (like France), employee share ownership has proven to be a viable route for aligning the interests of the corporation and the employees, while at the same time promoting the long term sustainability of corporations. Moreover the public outcry over variable remuneration of top executives may be reversed into a more positive perception if corporations would enlarge the concept of variable remuneration to a more inclusive approach, including granting shares or share options.

However attempts to introduce such system in other countries (e.g. in Belgium) have been without great success. Maybe that success will only come alongside additional complimentary factors. On the one hand, special fiscal treatment of such variable income might make such employee ownership more attractive. However there are also serious impediments. First and foremost, employees fear the downside such investments might entail, especially if these investments represent the only non-diversified investment employees possess. On the other hand, non-diversified investments make you care about your investment and this can generate a new dynamic in the company as far as employees are concerned. Additional points of attention are the ‘classical fight between capital and labour’ mentality, which is incompatible with important employee ownership. Caution has also to be paid to the pressure that employees can exercise in shareholders’ meeting to appoint board members.

ecoDa would agree that more attention should be paid by the Commission to further investigate possible regimes for employee shareholdership on a voluntary and contractual basis and what may be their conditions for success.

Set of questions on comply-or-explain

The flexibility offered by the comply-or-explain approach has been greatly appreciated, however the informative quality of the explanations is not satisfactory and compliance is not sufficiently monitored.

(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?

(25) Do you agree that monitoring bodies should be authorized 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?

Although ecoDa is of the opinion that the comply-or-explain approach should be continued, at the same time ecoDa is aware that major improvements are necessary to effectively monitor the governance of listed companies. Boiler plate reactions, copy and paste approaches from other companies are certainly unacceptable as valid explanations for deviating from the recommendations. Disclosing false information could even be considered as representing a form of market abuse. A more conscious reflection on each principle and its implementation in practice should lead to more specific and tailored reactions per company. In fact, the company should convince the external monitors that its approach is better suited for the specific situation of the corporation than the proposals of the code. Therefore, it is appropriate that besides the explanation for non-compliance, there is also disclosure of the alternative solution that has been adopted.
In order to facilitate such 'grounded' declarations, the institutions that are responsible for corporate monitoring and/or the institutions that developed the codes should invest more efforts into researching the quality of the explanations and what kind of relevant types of explanations can be observed. However, it is difficult for regulators to check all the information disclosed by listed companies without generating a bureaucratic exercise (although they could investigate in more detail – and discuss directly with companies – any egregious cases that are referred to them by company shareholders). Annual awards as organized in the UK to judge companies with the best explanations could be repeated in other countries.
Such developments would foster what has been referred to as a 'best fit' approach. According to this philosophy, corporate governance structures and procedures should be compliant with the basic principles of good governance while leaving the company with the responsibility to prove to the outside world that its practical implementation and fine tuning fits the company's strategy, ambitions, specific circumstances and challenges. Only when we have reached this stage will European governance represent a key component of a competitive European business environment.

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About ecoDa:

The European Confederation of Directors' Associations (ecoDa) is a not-for-profit association founded in December 2004 under the laws of Belgium. Its objective is to represent the views of company directors from EU member states to corporate governance policy-makers at EU level. ecoDa, the European Confederation of Directors' Associations, is a not-for-profit association acting as the "European voice of board directors". ecoDa seat is in Brussels.
Through its 13 national institutes of directors, ecoDa represents around sixty-five thousand board members from across the EU, ensuring that their views on Corporate Governance are clearly communicated to policymakers in the EU institutions. ecoDa's member organisations represent board directors from the largest public companies to the smallest private firms, both listed and unlisted.

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- The British "Institute of Directors" (IoD)
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- The French IFA
- The Luxembourg ILA
- The Finnish Association of Professional Board Members
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- The Slovenian Directors' Association
- The Polish Institute of Directors
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