

OECD
2, rue André Pascal
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FRANCE

Subject: Eumedion response to the Consultation on corporate governance and the financial crisis
Ref.: 2009.020
Schiphol, 16 April 2009

Dear Mr Kirkpatrick, *Dear Grant!*

We are writing to you to express Eumedion's views on the OECD consultation on corporate governance and the financial crisis. Please find below our views with regard to the questions regarding the governance of remuneration, the implementation of risk management, board practices and the exercise of shareholders rights. Please be informed that these remarks are in addition to the comments that I have made during the OECD meeting on 18 March 2009.

1. General remarks

Eumedion is the Dutch corporate governance forum for institutional investors. At present, Eumedion has 65 Dutch and foreign institutional investors as participants. Together, these participants have more than 1 trillion euro of assets under management. In brief, we will describe below that:

1. we believe that the remuneration policy of directors should be formulated in such a way that the focus of remuneration policies should be shifted more towards the long-term considerations and that risk management considerations should be embedded in the remuneration policy. Furthermore, we advocate that listed companies fully disclose their remuneration policies and put these policies (or a major change thereof) up for a binding shareholder vote.
2. we support improvements in the effectiveness of and disclosure on risk management. We believe that the risk management function should be made independent and responsible for effective independent stress testing. Risk officers should have a high rank in the company's hierarchy and the risk officer should report directly to the audit committee of the company on material issues periodically. In addition, we would like to recommend

that listed companies provide in their annual reports a summary of the most important, e.g. five specific, risks, and quantify if possible their potential impacts.

3. we believe that real improvements and a complete focus and ethical awareness should come from the individual financial institutions themselves. Therefore more attention is needed for the tone at the top and the 'fit and proper test' of directors and (supervisory) board members of financial institutions. Managing board members, non executive directors and supervisory board members must all have sufficient knowledge and understanding of the products their company sells or buys. They should properly understand any financial instruments and structured products held by the financial institutions, in order to be able to identify the corresponding risks and to challenge and monitor managing board members adequately.
4. we believe that shareholders rights should be strengthened instead of restricted.

2. Governance of remuneration of directors

Please be informed that at the end of 2006, Eumedion has published a set of recommendations on a good structure for the remuneration policy of directors of listed companies (please be referred to the attached "Recommendations on executive remuneration" of 25 October 2006). The participants of Eumedion are especially interested in realizing an effective structure for the remuneration policy for the management board. Hereto, the Eumedion recommendations contain several important and high level recommendations. Eumedion participants are principally concerned with the following most important principles:

- Alignment of the remuneration policy with the long-term objectives of the company.
- In normal circumstances, the long-term bonus should constitute a greater part of the total remuneration package than the annual (short-term) bonus.
- Conditional share and/or option allocation should lapse when company performance is below the median of the peer group.
- The remuneration policy for directors must be related to the remuneration policy for all employees of the company.
- The remuneration policy should be clear (easy to read), understandable, and the relation between the fixed elements and variable elements should be made clear.
- The remuneration policy should contain a claw back clause.

Eumedion would like to recommend the OECD to take these core principles into consideration in the drafting process of a new set of recommendations. In addition, we would like to state that:

- (i) in our view, the remuneration policy of directors should be formulated in such a way that the focus of remuneration policies should be shifted more towards the long-term considerations (see first and second bullet points above).

- (ii) we support the inclusion of non-financial metrics in the remuneration policy.
- (iii) we realise that poor structured remuneration policies could have an impact on the risk profile of the company and that these risks should be considered and managed properly. Risk management considerations should therefore be embedded in the remuneration policy.
- (iv) we believe that listed companies should disclose their remuneration policies and to put these policies (or a major change thereof) up for a binding shareholder vote. Shareholders should also have insight in the remuneration of all staff members that earn more than the members of the managing board. In the Netherlands, shareholders do have the right to vote on the remuneration policy and have, in some cases, used this right effectively to vote down proposed (changes in the) remuneration policy or have pressed the company to withdraw a draft proposal, which with shareholders could not agree. This shows that a binding vote is an effective mean that shareholders are willing to use in case they are faced with a remuneration policy that they do not agree with.
- (v) we support almost all elements of the Statement of the European Corporate Governance Forum on Director Remuneration, which has been published on 23 March 2009, with exception of the recommendation that severance pay should be restricted to two years. Instead, we would like to recommend restricting any severance pay to one year. Only in case the managing director's contract has been terminated within his first term, this could be lengthened to two years.

3. Implementation of risk management

The financial crisis shows once again the need of adequate risk management. Since several years, risk management of listed companies is an issue that has special attention of the institutional investors that are participants of Eumedion. In 2008 Eumedion has, in cooperation with the Royal Dutch NIVRA (Netherlands Institute for Register Accountants), conducted a research, which is called Insight in uncertainty, on the risk management reporting by Dutch listed companies. The main conclusions of this research were:

- (i) None of the Dutch listed companies that were reviewed reported on all aspects of risk management.
- (ii) Disclosure regarding risk management and internal control systems showed a wide diversity regarding the level of detail, the description of the risks and control systems and the quality and the scope of the in control statement.
- (iii) Only 10% of the Dutch listed companies that were reviewed gave insight into the most important risks associated with the company's strategy, although most

companies reported extensively on various forms of risks. These risks were however mostly not quantified, nor were they company specific¹.

Against this background, we support improvements in the effectiveness of and disclosure on risk management. We believe that risk management function should be made independent and responsible for effective independent stress testing, and that risk officers should have a high rank in the company's hierarchy and that companies should not rely on external ratings without additional internal risk assessment. Furthermore, we would advocate that the risk officer reports directly to the audit committee of the company on material issues periodically. In addition, we believe that financial institutions should (be legally obliged to) include an informative and readily comprehensible "broad" risk paragraph in their annual reports, comprising all information relating to risks and risk management (i.e. concentrated under a single heading in the annual report). In this broad risk paragraph the company should describe its most important potential risks and how these risks are managed. Shareholders have an interest in receiving sufficient information on risks and the systems companies have put in place in order to mitigate these. In brief, shareholders want to know what the business risks are, what chance there is that these risks materialize and what the impact of this would be on shareholders' equity and result. Institutional investors would appreciate a review of, for example, the five most important risks, instead of the naming of every conceivable risk. We furthermore recommend quantifying (especially the financial) risks in order to give shareholders more and better information. Summarizing risks has no added value if the possible consequences thereof are not made transparent. We therefore advocate that companies should insert a "sensitivity analysis" in the paragraph on risk management. Companies should quantify the effects of the risks on the position of the company and give insight in the chances that certain risks will occur. The alternative would be that each investor would have to make their assessment and consequently allow for some tolerance. This would lead to high cost of capital which would not be in the interest of good functioning markets and its participants. In our view, companies are best placed to perform risk assessment themselves.

4. Board practices

Firstly, we would like to stress that we believe that real improvements and a complete focus and ethical awareness should come from the individual financial institutions themselves. Financial institutions need to do their utmost in order to gain (back) the confidence of the public over time. Directors and board members of financial institutions need to set the tone at the top. If current financial top management cannot regain confidence, new management should replace them.

¹ Please be referred to page 8 and 9 (Executive summary) of the attached report of this research.

More attention for the tone at the top, also by supervisory authorities, is needed to pull us out of the current crisis. This should be a clear priority in the short term.

We believe that more attention needs to be paid to the 'fit and proper test' of directors and (supervisory) board members of financial institutions. Only people with relevant excellent skills and expertise are eligible to become managing director or board member of a financial institution. The financial crisis shows the necessity that managing board members, non executive directors and supervisory board members have adequate knowledge and expertise in order to manage or monitor the company effectively. Managing board members, non executive directors and supervisory board members must for example all have sufficient knowledge and understanding of the products their company sells or buys. The financial crisis has shown the complexity of financial institutions and has raised questions about the degree of technical skills and experience required of supervisory board members or non executive directors. They should properly understand any financial instruments and structured products held by the financial institutions, in order to be able to identify the corresponding risks and to challenge and monitor managing board members adequately. In addition, we believe that supervisory board members or non executive directors have to make a "change of culture" in order to challenge and criticise managing board members when necessary. The challenge of managing directors that pursue strategies that raise questions is of vital importance for sound financial markets. Supervisory board members or non executive directors should therefore act in such a way that managing directors perceive them as their internal supervisor monitoring their activities. Financial institutions should try to realise this themselves by including these relevant skills in the profile of supervisory board members or non executive directors.

5. Exercise of shareholders rights

The failure of the banking sector to communicate clearly on the risks of its business model has revealed shortcomings in corporate governance. The financial crisis has also raised questions about the culpability of shareholders. Although there are many different typologies of shareholders (as individual investors, pension funds, mutual funds, hedge funds, activists, short term shareholders, long term shareholders, sovereign wealth funds, trustees, etc.) with different perspectives and attitudes in terms of investing and exercising their voting rights, it has been suggested that shareholders have been insufficiently engaged or too demanding and that some shareholders sometimes took a short-term view. These opposing views illustrate the diverse nature of the issues surrounding shareholders and their role in ensuring good governance. However, shareholders, including institutional investors, face many difficulties in exercising their voting rights. The difficulties are (i) share blocking resulting in the absence of shareholders at general meetings, (ii) a lack of clarity about the question when concerted actions by shareholders

are considered to qualify as acting in concert (leading to a notification obligation or the obligation to make a public bid), (iii) the existence of structural anti take over devices, and (iv) high thresholds to dismiss board members. In order to have shareholders play a better monitoring role, these difficulties should be taken away which is not always the case in Europe. The suggestion to restrict shareholders rights is therefore not the right way forward. We believe that now more than ever investors should be more involved in monitoring their investments. The only way to realise this is by ensuring there are legal repercussions for (managing) board members. This means that shareholders rights should be strengthened and not restricted. In addition, it is necessary that board members and shareholders are willing to have a better dialogue with each other.

Although the strategy of the company is in the first place the managing board's responsibility which in principle should not be interfered with by shareholders, it is nevertheless clear to us that institutional investors should investigate which lessons they can learn from the financial crisis. This is why Eumedion has asked two researchers to examine a qualitative research on the mutual expectations of institutional investors and of the managing director and (supervisory) board members of listed companies. The results of this research will hopefully give more clarity on the role of institutional investors. These results will be made public at the end of 2009.

If you would like to discuss our views in further detail, please do not hesitate to contact us.

Yours sincerely,



Rients Abma

Executive director