Corporate Governance Developments in Europe: Where are we?

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European legal framework

• **European legal framework on Corporate Governance**
  – Starting point with the European Commission communication in May 2003 – « Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward »
    • The enhancement of disclosure
    • The reinforcement of shareholders rights
    • The modernisation of board of directors
    • The coordination of corporate governance efforts of Member States => A Commission Decision of 15 October 2004 established the European Corporate Governance Forum

• **Nationals initiatives**

• **The current legal framework at the European level is essentially based on two pillars :**
  – Directives (audit committee, principle of « comply or explain », procedural shareholder rights…)
  – Recommendations (which may be transposed into either law or code at the national level) (remunerations, independence of board members…)
## European legal framework

### Relation between EU legislation, national legislations and codes

*(sources: riskmetrics Group 2009)*

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* Low level of regulation; ** Medium level of regulation; *** Extensive level of regulation*
National levels

- At the national levels (hard and soft laws)
  - A mixture of laws and codes of governance depending on the cultural and historical approaches.
  - A mixture of public and private initiatives. The nature of initiatives is especially relevant when addressing monitoring and enforcement.
  - In several jurisdictions, some codes of governance are specifically designed for SMEs.
  - Statutory auditors may also play a role
National levels

- **Origin of the initial corporate governance code initiatives** *(RiskMetrics Group 2009)*

  
  *Note that the Financial Reporting Council, drafter of the UK Combined code, has some regulatory activities in addition to its primary role of professional association of auditors and actuaries.*
Enhancement of disclosure

- The enhancement of disclosure...in particular the quality of the disclosure

- The principle of « comply or explain » is engraved in European law and is the cornerstone of the European legal framework
  - Although, the implementation of this principle is generally satisfactory, the question of the quality of the disclosure and the explanations given need to be addressed
    - Some explanations can be insufficiently developed
    - Even when developed, some explanations may be unsatisfactory

- Europe generally tries to strike a balance between disclosure and mandatory requirements. However a crisis tends to favor a more mandatory approach
Reinforcement of shareholder rights

- How to ensure an equal treatment, in particular vis-à-vis of minority shareholders?

- How to favor a better participation of shareholders
  - Specific incentives?
  - Better draft resolutions?
  - Electronic participation?

- Do we need a better transparency on...the shareholders side and in which circumstances?
Modernisation of board of directors

- More stringent approach for large companies
- Even more stringent approach for credit institutions
- Adapted approach for SMEs

- **Composition**
  - Limiting executive directors outside directorships
  - Diversification of board members
  - Definition and process of selection of independent directors

- **Board accountability**
  - Assessing the boards work and monitoring its result

- **Specialised committees**
  - Audit committees (including their composition) became mandatory with some exemptions
  - Remuneration and nomination committees are still popular
  - Rising interest in particular in strategic committees, environemental committees….
Monitoring and Enforcement

• **Different ways to monitor and enforce which depend on**
  – the source of the principle: Law; Code of governance; Listing rules; Market authority; recommendations…
  – the competent authority in charge of implementing and supervising: Judiciary system; Market authority; Stock exchange; ....shareholders!
  – and the nature of the monitoring: availability of information; analysis of the information given.

• **French specificity: annual report on corporate governance published by market authority**
  – French law requires the AMF to publish an annual report on corporate governance, executives remunerations and internal control procedures in listed companies
    • The AMF issues recommendations on how listed companies should implement corporate governance codes
    • The AMF also raises topics for discussions on how some corporate governance principles could be implemented or developed in light of new developments
Future developments

- The European Commission has recently launched a consultation on corporate governance in credit institutions and remuneration policies that details possible ways to deal with the following issues:
  - How to improve the functioning and the composition of boards of financial institutions in order to enhance their supervision of senior management;
  - How to establish a risk culture at all levels of a financial institution in order to ensure that long-term interests of the business are taken into account;
  - How to enhance the involvement of shareholders, financial supervisors and external auditors in corporate governance matters;
  - How to change remuneration policies in companies in order to discourage excessive risk taking.

- The European Commission has launched a consultation on the audit sector and how it works

- The European Commission is expected to publish a consultation paper before summer 2011 on corporate governance in listed companies

- The role and the ecosystem of the shareholders meetings should also be raised next year: Proxy advisors, empty votings….