CONTRACT NO. ETD/2008/IM/F2/126:

STUDY ON MONITORING AND ENFORCEMENT PRACTICES IN CORPORATE GOVERNANCE IN THE MEMBER STATES

Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States

23 September 2009

STUDY CONDUCTED BY MAIN CONTRACTOR:

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ACKNOWLEDGEMENTS

This Study was undertaken by RiskMetrics Group in collaboration with BUSINESSEUROPE, ecoDa and their affiliated members, and Landwell & Associés and their network of European affiliates. The completion of this Study represents a considerable team effort involving offices and individuals from all EU Member States, reflecting and building on opinions of all parties involved in the corporate governance arena: regulators and companies, as well as investors.

As the project leader of this Study, I would like, on behalf of RiskMetrics Group, to express our gratitude to everybody who has contributed to this Study.

First, I would like to thank the members of the European Commission for inviting us to perform this in-depth research project that pursues the ambitious goal of analysing the different monitoring and enforcement mechanisms of corporate governance rules in the various EU Member States. I thank Commissioner McCreevy and Head of Unit Claire Bury. I am grateful to Ms Corinna Ullrich, Mr Elies Messaoudi, and the members of their team for their comments and guidance as well as for the productive working relationship developed over the course of this research project.

I would also like to express my appreciation to the members of European Corporate Governance Forum for providing their important input and comments to the structure and content of this Study. Their intellectual support and guidance was very beneficial in the identification of the core research topics.

I also extend my gratitude to the members of the *corporate governance network of securities regulators and representatives of stock exchanges* and, in particular, its chairman Mr Chris Hodge, for providing invaluable help in analysing the monitoring and enforcement systems in the various EU Member States, and sharing their views on the possible routes for improvement.

My thanks also go to all the investor organisations which devoted their time to respond to our investor survey, as well as all the business associations and director organisations which participated in the company perception survey. In addition, I would like to thank all the companies that responded to RiskMetrics' call to verify our findings of the company practice analysis. The responses from all these parties enabled us to draw a comprehensive picture of the functioning of corporate governance codes across the EU and provided a strong basis from which to draw our conclusions and recommendations.

Further, I would like to thank our partners for their considerable contribution in this Study. Ms Béatrice Richez-Baum (ecoDa) together with colleagues Dr Roger Barker (IoD) and Ms Astrid Rubens (GUBERNA), as well as Ms Marta Alegrias from BUSINESSEUROPE contributed their time and efforts to elucidate the perception of companies and directors with regard to the functioning of corporate governance codes across the EU. Landwell & Associés, represented by team leaders Messrs Régis Carral, Christophe Guénard, and Jean Melcion, and all their affiliates in the 27 Member States, brought in their expertise to provide an overview of the legal framework and the functioning of corporate governance codes in each EU Member State. I am grateful to all our partners for the cooperative atmosphere and great effort in keeping this Study run smooth and timely.

Moreover, I would like to express my gratitude to all the members of the various RiskMetrics teams who contributed to the project. I would like to thank the analysts who performed the analyses of the corporate governance practices of 270 European companies in 18 Member States: Orsolya d'Alboy-Gal, Gabriel Alsina, Alberto Bagnara, Thibaut Barsacq, Stefanie Claeys, Demid Fedorov, Stefan Georgiev, Leonidas Gikas, Ian Greenwood, Karoline Herms, Arnaud Heynderickx, Adriana Iacobita, Daniel Jarman, Patricia Kanashiro, Cédric Lagrange, Tomi Lakkonen, Faryda Lindeman, Aneta McCoy, Anders Nordheim, Thomas von Oehsen, Juan Pajuelo, Caryl Pierre, Frédéric Rottier, Juha Sarin, Guillaume Tassin, Salvatore Tedesco, Veronika Tomusiak, Stuart Weavers, and Philip Westwood. They were backed in this task by RiskMetrics' regional experts, among whom I would particularly like to thank Ms Karin Lindh Ithuralde for her help throughout the various stages of the project. I would also like to thank our marketing and account management teams, and, in particular, Ms Sarah Ball, for the conception of the investor survey and the close follow-up with investors. My gratitude also goes to Ms Sabrina Martinez who coordinated with Landwell & Associés on the legal research. I also extend my thanks to my team of proofreaders, namely Messrs Leonidas Gikas, Anders Nordheim, Martin Wennerström, and Robert Yates who thoroughly scrutinised and edited the final report. All these participants contributed their time, diligence, and expertise to this Study, notwithstanding numerous other projects and commitments.

Finally, I would like to extend a very special word of thanks to the managers of this project, Messrs Kristof Ho Tiu and Jérôme Le Page, and Ms Olga Skripova. They led the project teams, coordinated them across borders, liaised with our partners and were instrumental in drafting and producing the final report.

Jean-Nicolas Caprasse
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EXECUTIVE SUMMARY

Scope of the Study

This Study provides an overview of the various monitoring and enforcement mechanisms in the Member States of the European Union concerning corporate governance rules that are laid down in codes of corporate governance. It assesses the level of compliance of companies with the provisions of corporate governance codes and examines the availability and quality of explanations for deviations from these codes for a sample of 270 listed companies from 18 Member States. Two surveys were conducted in the framework of this Study. They aimed at evaluating the perception of corporate governance codes by director institutes and business associations on the one side, and EU shareholders on the other side. On this basis, the Study evaluates the effectiveness of the different monitoring and enforcement systems and presents suggestions to improve their effectiveness.

The comply-or-explain approach as a pan-European mechanism

The comply-or-explain principle has become a feature of the EU approach to corporate governance. National corporate governance codes lay down rules or recommendations that are not mandatory, but with which companies must either comply, or explain deviations. In 2006, the European Commission issued Directive 2006/46/EC[1], introducing the comply-or-explain principle for the first time in European law. It mandates the application of corporate governance codes by way of comply-or-explain - or alternatively allows the application of company-specific extra-legal principles.

The distribution of corporate governance-related principles between law and codes in each Member State naturally depends on a number of factors, including legal tradition, ownership structures, and the maturity of the corporate governance tradition. Some general features may nonetheless be observed at European level. Some topics are in most instances regulated by law, often following European legislation: general board organisation, audit committees, statutory audit, as well as procedural shareholder rights. Other topics are more often treated in codes: board members' independence, remuneration and nomination committees, or internal control and risk management. These categories are however not clearly defined and vary between Member States. Certain topics can also evolve from code-based norms to regulated rules, as the recent takeover by regulators of the remuneration issue shows in some Member States.

In almost all Member States, codes are regularly updated, although only six Member States have established formalised procedures for the update of the codes. This confirms the notion that codes are flexible but also living instruments, which adapt to changing legal, economic, and social realities.

In terms of monitoring and enforcement, market-wide monitors (financial market authorities and/or stock exchanges) mainly monitor the availability of information on corporate governance. In some cases they also perform some analysis of the informative value of corporate governance statements and publish the results thereof. However, in only a few cases does this analysis contain information about companies' compliance on an individual basis. Financial market authorities tend to be more active monitors than stock exchanges. Monitoring by market-wide monitors is more common in Member States where block holders are widespread and where there is limited ownership by institutional investors (e.g. Spain). In such Member States the monitoring by market-wide monitors balances the limited monitoring activity by shareholders.

[1] Directive 2006/46/EC of the European Parliament and of the Council dated June 14th, 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings; available at: http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_224/l_22420060816en00010007.pdf.

The monitoring responsibility of shareholders is still largely unregulated. Only in a very limited number of Member States (France, the Netherlands, Portugal, and to a lesser extent the United Kingdom) are shareholders encouraged to adopt a more active monitoring role via the publication of their involvement in voting at general meetings.

Broad support for the comply-or-explain approach

The careful scrutiny of the various market participants' opinions shows an overwhelming support for the comply-or-explain regime from regulators, companies or investors:

- ***Regulator perspective:*** The comply-or-explain approach enjoys the support of regulators both on EU and national level. The European Commission expressed its preference for this approach by adopting the Directive 2006/46/EC, which mandated the application of corporate governance codes by way of comply-or-explain. Moreover, even before the harmonisation at EU level, the comply-or-explain mechanism had already been endorsed by many Member States. The European Corporate Governance Forum had also expressed strong and unanimous support for the comply-or-explain approach in 2006, as it judged it "best suited to take into account the variety of situations of individual companies" [2], and as it was considered to adapt well to the differences between national laws and governance framework. The ECGF, supported in this by the European Commission, considers that "when it is effectively implemented, this is better and more efficient approach than detailed regulation". Therefore, the comply-or-explain approach is currently considered the preferred regulatory technique by regulators.

- ***Company perspective:*** The results of the company and director perception survey presented in Chapter III of this Study demonstrate that the great majority of respondents consider soft regulation in the form of corporate governance codes applied on a comply-or-explain basis to be an effective regulatory tool. It is considered to offer sufficient flexibility to accommodate the specific situations of companies. There is a clear indication that soft regulation on a comply-or-explain basis is preferred to hard law, the reason for this being the ability of the comply-or-explain mechanism to take the diversity of needs of listed companies into account. Additionally, the majority of respondents believe that the benefits of implementing corporate governance codes exceed the implementation costs.

- ***Investor perspective:*** The results of the survey of 100 large institutional investors and institutional investor organisations presented in Chapter IV of this Study conclude that the majority of respondents support the comply-or-explain regime. Moreover, more than half of the respondents think that there is an acceptable balance between legislation and comply-or-explain-based codes. According to them, the combination of law and codes covers all important issues relating to corporate governance. While being generally positive to the comply-or-explain system, investors point to the low disclosure quality of company statements. They also support the enhancement of both shareholder rights and shareholder responsibilities.

[2] Statement of the European Corporate Governance Forum on the Comply-or-explain Principle, dated February 22nd, 2006; available at: http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf-comply-explain_en.pdf.

Strengthening the practical application of comply-or-explain

Although the comply-or-explain approach is considered an appropriate and efficient regulatory tool by a large majority of market actors and regulators, there is also a wide consensus that the mechanism does not function perfectly. Moreover, deficiencies in corporate governance practices have been highlighted as one of the causes of the late 2000 financial crisis[3].

Companies bear the onus for the lack of implementation of good corporate governance practices, for example in the fields of risk management and remuneration, and for inadequate reporting of their practices.

The onus also falls on investors' shoulders for not exercising their monitoring and enforcement responsibilities diligently. As UK Treasury Minister Lord Myners put it, investors themselves often acted as "absentee landlords"[4]. Although investors have extensive rights to directly or indirectly influence the governance of listed companies, they have been "too reliant and unchallenging" with regard to corporations[5]. Investors have been publicly criticised for not having dedicated enough time and resources to ensure effective monitoring. Certain types of investors have also been criticised for not properly managing their conflicts of interest and actively encouraging short-termism in companies.

Quality and comprehensiveness of company disclosure

The survey to investors performed by RMG indicates investors' limited satisfaction with the quality of company disclosure. Indeed only a quarter of respondents consider the quality of company disclosure sufficiently good.

Simultaneously, and in order to put investors' judgement in perspective, an analysis of the compliance level, and of the availability and quality of explanations for deviation areas by companies was conducted on a sample of 270 companies in 18 Member States[6].

This analysis demonstrated that almost all companies refer to a reference corporate governance document, which in most cases is the national corporate governance code of the country where the companies are domiciled. Only a handful of companies did not refer to any corporate governance reference document.

Overall 86 percent of all companies disclose some type of comply-or-explain information[7]. Of the companies disclosing such information, 23 percent disclose compliance with all or most provisions. Some companies (39 percent of companies disclosing comply-or-explain information) disclose information on a provision-per-provision basis.

In total 1,141 explanations for deviations of the reference corporate governance code were identified in the total sample of companies analysed. For the purpose of this Study, the explanations were classified into five categories: Invalid, General, Limited, Specific, and Transitional[8]. While the first three categories correspond to a lower level of informative quality of explanations deviations,

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[3] ICGN, Second Statement on the Global Financial Crisis, dated March 23rd, 2009; available at: http://www.icgn.org/files/icgn_main/pdfs/news/icgn_statement_on_the_financial_crisis_23_march_09.pdf.

[4] Speech by Lord Myners delivered on April 21st, 2009 at the conference at Association of Investment Companies; available at: http://www.hm-treasury.gov.uk/speech_fsst_210409.htm.

[5] The Crisis: the role of investors, speech by Hector Sants, Chief Executive, FSA NAPF Investment Conference 2009, March 11th, 2009, available at: http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0311_hs.shtml.

[6] 74 companies were classified as large-cap companies and 196 companies were classified as mid-cap companies.

[7] The companies not disclosing such information are domiciled in Greece, where no corporate governance code was identified, in Bulgaria (with the exception of two companies) where the code entered into force after the start of this Study. Furthermore three French companies did not disclose such information, as the comply-or-explain approach only entered into force after the start of this Study. Finally, three Luxembourg companies and one Italian company did not disclose comply-or-explain information.

[8] Explanations for deviations which only indicate a deviation without further explanation were classified as "invalid". Explanations of a general nature in which the company mostly indicates disagreement with the code provision without identifying a company specific situation, were classified as "general". Explanations in which companies do not explain the reasons for deviating from the code, but where additional information was given such as an alternative procedure, were classified as "limited". Explanations relating to a specific company situation were classified as "specific". Finally, if companies indicated that the code provision from which they currently deviate will be applied at a later stage, these explanations were classified as "transitional".

specific and transitional explanation provide a level of information that adequately matches the objectives of the comply-or-explain mechanism. The overall level of "informative explanations" (i.e. "specific" or "transitional") is rather low in the EU. Only 39 percent of all explanations on the reference corporate governance code are classified as sufficiently "informative". The highest proportion of "informative" explanations comes from companies registered in France, the Netherlands, Sweden and the United Kingdom.

Interestingly, the aggregate results of the director institute and business association survey on the matter show similar results. Although the differences of methodology used for the survey and RMG's assessment make parallel observation more complex, the overall assessment of the quality of explanations is somewhat comparable. Indeed the proportion of specific explanations is considered to represent around one-third of all explanations provided by companies for deviations from the codes.

When reviewing the detailed results of the informative quality of explanations for deviations provided by the sample of 270 listed companies analysed by RMG, the "specific" explanations most often provided by companies refer to the presence of an important shareholder (16 percent of the "specific" explanations). This result has been found in nearly every country, especially in Belgium and Spain. Other "specific" explanations were generally based on the specificity of company activities, legal references, specific board composition or position of the chairman, set up of a contract before the corporate governance code entered into force and costs related to executing the code provision.

When examining the influence of important shareholders on the informative quality of explanations, no explicit link appears. For instance, while the analysis highlighted a low presence of important shareholders in the UK and the Netherlands (respectively 2 and 3 out of 15 companies had at least one identified important shareholder) and a significant presence of important shareholders in Sweden (all analysed companies had at least one identified important shareholder), these three markets are characterised by displaying the most "informative" explanations.

Companies mainly provide comply-or-explain information on board of directors and remuneration, these two topics together making up almost two-thirds of all explanations collected. Other recurrent topics of explanations for deviation include: shareholder rights and duties, disclosure, audit, and other issues (risk management, internal audit function, corporate secretary, and irregularity declaration procedures for employees).

"Informative" explanations are provided mainly on topics related to "audit committees" (56 percent of "informative" explanations) and on "shareholder rights" (52 percent of "informative" explanations). The topic on remuneration contains the least "informative" explanations: only 27 percent of all explanations related to remuneration are classified as "informative". Differences between countries can be significant, but follow the overall trend of all explanations.

When making the distinction between companies disclosing comply-or-explain information on a general basis and companies disclosing information on a provision-per-provision basis, the latter group provides on average a significantly higher number of explanations. Within this group of companies, the average number of explanations is also higher for mid-cap companies than for large-cap companies.

Apart from companies domiciled in Estonia[9], Hungary, Portugal and Spain – where such disclosure is mandatory or strongly recommended -, another 33 companies in various Member States voluntarily disclose on a provision-per-provision basis. In most of these countries, notably in Italy, Luxembourg, the Netherlands, Poland and, the UK, companies disclosing on a provision-per-provision basis disclose a higher number of deviations as their counterparts disclosing only general information. Therefore, whether they are obliged or recommended to disclose on a provision-per-provision basis, or whether they do this on a voluntary basis, companies disclosing on a provision-per-provision basis list an overall higher number of deviations.

[9] In Estonia, 14 out of 15 companies disclose comply-or-explain information on a provision-per-provision basis.

The discrepancies between the two groups (general vs. provision-per-provision disclosure) suggest that in cases where companies do not disclose deviations on a provision-per-provision basis, they might fail to fully disclose all deviations. This may seriously hinder the possibilities for shareholders and other monitors to detect deficient corporate governance practices and react accordingly.

Looking at the quality of these explanations, companies disclosing general information tend to disclose explanations with a higher informative value than companies disclosing information on a provision-per-provision basis. This is especially the case for the group of mid-cap companies.

This observation suggests that companies disclosing comply-or-explain information on a provision-per-provision basis may be tempted to treat disclosure requirements more as a box-ticking effort. Indeed, in those markets where provision-per-provision disclosure is required, proportionally more deviations are disclosed without further explanation as to the reasons for deviation.

On balance, the provision-per-provision disclosure format tends to foster more extensive disclosure, though at the cost of a lower quality of the information provided.

Level of activity of institutional investors

The comply-or-explain approach traditionally relies on investors to monitor and enforce corporate governance codes. Shareholder participation ought to place corporate practices under closer scrutiny and lead to increased shareholder involvement against poor corporate governance standards. However, to make such a claim necessarily implies that shareholders place value on their right to voice opinions on key decisions at shareholder meetings, and exercise their rights. Moreover, to assert this claim is to advance the notion that shareholders have come to accept their role as essential in the greater attempt to monitor corporate practice.

RMG surveyed Institutional investors on their corporate governance practices. Out of over 2,000 solicited institutional investors, only 100 responded to the invitation to participate in this Study. The majority of investors who declined to participate in the Study claimed a lack of resources or necessary expertise to fill in the survey questionnaire. The launch of the survey at the beginning of 2009, in the midst of the financial crisis, might also explain the limited participation of investors. Additionally, it should be stressed that almost half of the respondents are UK-based investors, and in total two-thirds of respondents come from the UK, the Netherlands or France. Such statistics could show that the respondents form a self-selecting group of institutions that actively participate in the corporate governance field.

Out of the sample of 100 respondents, the vast majority has a corporate governance or voting policy, and almost three-quarters publicly disclose this information. The vast majority of respondents exercised their voting rights in the course of 2008, usually on all or the largest proportion of companies in their portfolio as well as all or the largest part of their assets under management. Three-quarters of respondents state that the implementation of their corporate governance or voting policy includes engagement. Engagement activities most usually take the form of a combination of activities (correspondence, conversations and meetings with the board, physical attendance at general meetings) rather than consisting of one single activity. Just over four-fifths of respondents report on voting and engagement activity, which can take the form of disclosing full voting records, summary reports, details on each vote cast against management, or other forms.

The low response rate of this investor survey suggests that the institutional investor community consists of two distinct parts: a small active minority and a majority of more passive investors. The former tend to exercise their shareholder rights actively.

Many influential organisations echoed the view that the investors are often inactive and that more engagement is required. For example, the issue regarding the passivity of some investors was mentioned in the ICGN statement as of March 23rd, 2009. The ICGN explicitly recognised that "many investors did not invest the time or resources to provide effective oversight"[10].The European Fund and Asset Management Association (EFAMA), as well as a number of national asset management

[10] ICGN, Second Statement on the Global Financial Crisis, dated March 23rd, 2009; available at: http://www.icgn.org/files/icgn_main/pdfs/news/icgn_statement_on_the_financial_crisis_23_march_09.pdf.

associations also came to the same conclusion. This situation is all the more prevalent in Member States with concentrated ownership, and where no framework to encourage transparency from investors has been put in place.

Creating a genuine obligation to comply-or-explain

Directive 2006/46/EC has already been transposed in the majority of EU Member States (except in Belgium, Greece, and Malta). Nevertheless, the fact that the Member States have used different legal instruments (law, securities regulation, codes) to implement the requirement to publish a corporate governance statement can be a source of difficulty in the case of cross-border listing situations, whereby a company might find itself bound to comply either with several different codes or with none at all.

The majority of Member States do not have any provisions to remedy such situations. However, on March 23rd, 2009 the European Corporate Governance Forum proposed to introduce a set of new rules[11]:

- If the Member State of registered seat and the Member State of primary listing are different, the company should choose to apply the corporate governance code in either the Member State of its registered seat, or the Member State of its primary share listing.

- A Member State can only require that a company that is either registered in that Member State, or the shares of which are admitted to trading on a regulated market in that Member State, but which applies another Member State's corporate governance code, explains in what significant ways the actual corporate practices of that company deviate from those set out in the Member State's corporate governance code.

The proposed rules would ensure that a company complies with at least one code, while simultaneously avoiding the potential requirement to apply two or more codes. Conventions or agreements between the EU and relevant non-EU countries have been negotiated to handle cases of complex listing situations involving listing in a non-EU Member State. A more systematic extension of these instruments with relevant non-EU countries on the model of the rules proposed by the ECGF could also be considered.

Enhancing the role of market-wide monitors

The analysis of the practices in some Member States demonstrates that the functioning of the comply-or-explain mechanism could be improved by granting more monitoring powers to market-wide monitors. Provided that market-wide monitors show sufficient independence, they could help to improve the availability of information and increase the level of transparency needed for an effective monitoring by shareholders.

This could be achieved by granting them the authority to verify the availability of information disclosed in the corporate governance statements of companies. Market-wide monitors could further play an important role in improving the quality of disclosure by assessing the informative value of information disclosed by companies. The monitoring activities may include issuing recommendations on the content of corporate governance statements, publishing analyses on the results of monitoring (at an aggregate level as well as on a company-by-company basis) and engaging with individual companies regarding the content of the information disclosed. In most severe cases, formal sanctions could be considered.

Additionally, the availability and quality of information could be further enhanced by the introduction of reporting standards to be used by companies for their corporate governance statements. On balance, the results of the overall analysis conducted for this Study points to the need for regulators to foster complete and trustworthy disclosure by companies, while ensuring this objective does not jeopardise the quality of information provided. In this respect, provision-per-

[11] Statement of the European Corporate Governance Forum on Cross-border issues of Corporate Governance Codes, dated March 23rd, 2009; available at: http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf-crossborder_en.pdf.

provision disclosure could constitute an adequate framework to achieve this dual goal. Moreover, in cases where information is provided in a standard form and on a provision-by-provision basis, the information would be easier to search, process and compare, hence creating a level playing field for investors to compare corporate governance information across the board. To avoid formulaic explanations, the standard could be structured as multiple detailed headings under which companies could give freeform responses.

Extending the role of statutory auditors

Currently at EU level, statutory auditors are merely required to undertake a formal verification of company compliance with the requirement to publish a corporate governance statement. However, in order to improve the accuracy of information, their role could be extended to include the verification of the accuracy of certain facts disclosed in corporate governance statements. Limited to a verification of factual elements only, and structured by a standardised methodology, those assessments should not require the auditor to make any value judgement.

Enhancing shareholder rights and responsibilities

Enhancing the monitoring responsibilities of market-wide monitors and statutory auditors is mainly advocated as a way to improve the framework in which shareholders can exercise their monitoring and enforcement responsibilities. As the owners of companies, shareholders are ultimately best-placed to monitor corporate governance arrangements made by boards of directors, and to most effectively hold boards of directors accountable.

The European Commission has already urged Member States to provide for a number of rights to allow shareholders to actively engage with companies, whether procedural, in terms of access to general meetings and voting, or material, on the issue of executive remuneration for instance.

However, shareholder rights could be further enhanced by ensuring that company general meetings also be a forum for discussion on corporate governance practices. This could be achieved by introducing requirements to put the discussion of the corporate governance policy or statement as an item on the general meeting agenda, introducing an advisory vote on corporate governance policy or statements, or even introducing a mandatory vote. Shareholders would be offered the opportunity to express their opinion specifically on corporate governance arrangements made by company boards. One Member State has already incorporated this feature into its governance framework.

On the other hand, the efforts made to ensure that shareholders are provided with sufficient rights are only relevant if shareholders actually exercise these rights. However, as already indicated, many shareholders do not actively use them. Rather they rely on others to provide effective monitoring by engaging and communicating with companies. This passive behaviour creates a well-known free-rider problem, which constitutes a severe market failure from a macro-economic point of view.

Very few market participants believe this market failure can be properly addressed by imposing a mandatory requirement for institutional investors to use their voting rights. In fact, this is considered unnecessary if not counterproductive.

However, the issue could be remedied by imposing disclosure standards on how institutional investors address their fiduciary responsibility as owners of companies. The situation in four countries – France, the Netherlands, Portugal, and the United Kingdom to a certain extent – is illustrative of the positive effect such a measure could have on investor's level of activity. Indeed, evidence of this Study shows that free float investor participation at general meetings is more important in those countries where investors have a duty to report on their engagement and voting policy. In this respect, it is worthwhile to point out that two-thirds of the 100 respondents who participated in the investor survey conducted in the framework of this Study are based in Member States with mandatory or recommended disclosure obligations for investors (66 investors come either from France, the Netherlands, Portugal or the United Kingdom). This correlation could be the sign of an enhanced involvement of investors from these Member States in the comply-or-explain governance debate.

More specifically, investors could be required to disclose their investment and voting policies, as well as voting records for their portfolio companies. These recommendations were incorporated by the European Commission as medium-term objectives in its 2003 Action Plan and later left aside due to indecisive public support on this issue. The time could now be right to consider again implementing these recommendations. The majority of institutional investors surveyed in this Study support the requirement that *all* institutional investors be obliged to report on the implementation of their corporate governance policy. This suggestion would improve disclosure standards on monitoring activities for all EU-registered institutional investors. Furthermore, it would also be relevant in Member States where investor disclosure systems are already in place, as evidence suggests that even in those countries, a significant proportion of institutional investors fail to report in detail on their voting and monitoring activities.

Moreover, the European Commission could promote the adoption by Member States of national codes of best practice by institutional investors. Such “principles of stewardship” of communication and engagement could follow a comply-or-explain approach rather similar to the one adopted for companies. These principles, representing a market standard for investors in each Member State, should most preferably be developed by professional organisations of investors. These organisations are best placed to set the foundation of market driven principles for quality investor disclosure in each Member State, before it could evolve into more formalised, possibly European standards. In Member States with nonexistent, too weak or insufficiently representative investor associations, the development of a code of conduct might however need the impetus of other actors, including regulators or ad hoc expert commissions. In this framework, institutional investors would have to either comply with the principles of the code or explain why they elect to deviate from certain provisions of the code. Over time, these disclosure requirements could facilitate changes in investor behaviour, encouraging a more considered and informed use of their rights.

Conclusion

The comply-or-explain approach formally adopted by the European Commission in 2006 enjoys wide acceptance by the corporate as well the institutional investor community. However, its practical implementation suffers some deficiencies, mainly in the form of an unsatisfactory level and quality of information on deviations by companies and a low level of shareholder monitoring. These issues could be remedied by strengthening the role of market-wide monitors and statutory auditors, creating a reporting framework to ensure comprehensive and qualitative disclosure by companies, and by developing a comply-or-explain regime for institutional investors. The comply-or-explain regime should not be abandoned. It should be strengthened.

INTRODUCTION

This *Study on Monitoring and Enforcement Practices in the Member States* was undertaken by RiskMetrics Group (hereinafter "RiskMetrics") in collaboration with subcontractors BUSINESSEUROPE and ecoDa – which were responsible for the analysis of company and director perception of corporate governance codes - as well as Landwell & Associés and its network of European affiliates - which were responsible for the primary legal analysis. The Study is submitted within the framework of the European Commission's invitation to tender MARKT/2008/23/F.

The purpose of the Study, as described in the invitation to tender, is to provide an overview of the different monitoring and enforcement mechanisms concerning corporate governance rules laid out in codes or other forms of soft law in the Member States. The Study highlights the experiences of the various countries and their respective systems, the corporate governance problems identified through these systems, and the reactions to these problems. This Study also sets out to evaluate the effectiveness of the various monitoring and enforcement systems and provide recommendations concerning the elements needed to ensure their effectiveness.

The Study also evaluates the perception of mainly EU-based shareholders concerning explanations given by companies for their deviations from the corporate governance rules that apply to them.

To reach these objectives, the Study was divided in five parts:

- Chapter I provides a description of the various national corporate governance codes and examines their relationship with the applicable national legislation. This chapter also catalogues the existing monitoring and enforcement mechanisms in place in the 27 Member States.

  To this end, this chapter analyses the relationship between legislation and 'soft' law (codes) in corporate governance, examines the existing monitoring and enforcement mechanisms in the Member States, and evaluates their effectiveness. This chapter also focuses on Member States' reaction to the results obtained through monitoring mechanisms and on the responsibilities of securities regulators as well as Member States in terms of enforcement and enforcement effectiveness.

  This chapter was drafted by RiskMetrics, based on a legal analysis performed by Landwell & Associés and its network of European affiliates for each of the 27 Member States.

- Chapter II examines how the EU companies refer to corporate governance codes. It reviews the availability and quality of explanations and justifications given by companies based on a sample of 270 companies listed in 18 EU countries, as identified by the European Commission.

  To this end, an analysis grid was prepared to identify the explanations provided by companies on their compliance with corporate governance codes and assess the extent to which companies provide meaningful justifications where they deviate from the codes they reference. The analysis also addresses a number of corporate governance elements, including director independence, controlling shareholders and the specific rules possibly carved out for them, shareholder influence on board composition, remuneration statements, and audit committees.

  This chapter was drafted by RiskMetrics country analysts covering each of the 18 Member States under the supervision of regional experts.

- Chapter III provides information on company and director perception of corporate governance codes and on the current monitoring and enforcement practices in the EU.

  To this end, a survey was prepared and distributed to business associations and institutes of directors across the EU. The analysis of results from this survey provides insight on a number of issues, including the objectives and effectiveness of corporate governance codes, the structure and content of the codes, the complementary aspects of legislation and corporate governance codes, the comply-or-explain approach, and the costs of compliance with corporate governance codes.

  This chapter was drafted by BUSINESSEUROPE and ecoDa, based on a common survey developed by GUBERNA (member of ecoDa), discussed by RiskMetrics and approved by the European Commission. 42 ecoDa and BUSINESSEUROPE members from 25 EU Member States responded to the survey.

- Chapter IV provides information on investor perception of corporate governance codes and on the current monitoring and enforcement practices in the EU.

  To this end, a survey was prepared and emailed mainly to European-based investors. The analysis of results from this survey sheds light on a number of issues, including investor assessment of company corporate governance disclosure and explanations, assessment of investors' own corporate governance practices, and assessment of investor perception on their entitlement to exercise their rights.

  This chapter was drafted by RiskMetrics, based on a survey developed by RiskMetrics, approved by the European Commission and emailed to over 2,000 mainly EU-based institutional investors. 100 mainly EU-based investors, representing over EUR 400 billion of assets under management in the EU, responded to the survey.

- Chapter V draws analytical conclusions focusing on the existing monitoring and enforcement mechanisms in the Member States as far as corporate governance codes are concerned, and provides recommendations as to the elements needed to ensure monitoring and enforcement mechanism effectiveness.

  This chapter was drafted by RiskMetrics, based on the findings of the first four chapters. It also refers to some recommendations made by European-wide as well as national regulators, financial market authorities, trade bodies and academics.

At the end of this Study, two annexes present:

- a summary methodology (Annex 1), and
- a list of abbreviations used throughout the Study (Annex 2).

Finally, three separate appendices present:

- the legal analysis for each of the 27 Member States (Appendix 1),
- the country findings of the company and director perception survey for the 25 Member States covered (Appendix 2), and
- the detailed methodology, including the templates of the analysis grid used for Chapter II, as well as the two questionnaires used for Chapter III and Chapter IV (Appendix 3).

CHAPTER I – LEGAL ANALYSIS

1 INTRODUCTION

Chapter I of this Study examines the national regulatory framework of all 27 EU Member States, by describing the relation between legislation and corporate governance codes in the different Member States. Specifically, this chapter addresses the following questions:

- how do legislation, listing rules, and corporate governance codes operate in conjunction with one another,
- who are the authors of the codes,
- what are the law and the codes' respective scopes of application,
- is there a formal obligation, and, if so, in which instrument, to apply a code by way of comply-or-explain,
- do national rules provide a solution to the problems presented by complex listing situations,
- and, more generally, in which instruments are individual issues regulated (code, law, listing rules).

Additionally, Chapter I also presents the various monitoring and enforcement mechanisms in each of the 27 Member States, and aims to identify:

- those private and public bodies at Member State or company level which are responsible for updating corporate governance codes and monitoring company implementation of code provisions,
- the way these bodies, or the Member States themselves, react to the results obtained through these monitoring mechanisms, including the frequency of such updates,
- the responsibilities of the various monitoring and enforcement bodies in the context of each of the 27 Member States,
- the role that the authorities in the various Member States' and/or shareholders have to play in improving the quality of the justifications given by companies under the comply-or-explain principle,
- the best practices in terms of enforcement mechanisms, including the specific prerequisites for the different systems to function.

Methodology

This chapter has been drafted by RiskMetrics, on the basis of a legal review of the 27 EU Member States performed by Landwell & Associés and its network of European affiliates, based on their corporate governance expertise and experience. After having agreed with RiskMetrics on a defined analysis template approved by the European Commission, one designated lawyer specialising in corporate governance issues has been placed in charge of the aforementioned assignment for each of the 27 Member States[12].

[12] See Appendix 1 for the individual country legal analysis.

2 GENERAL BACKGROUND TO THE LEGAL ANALYSIS

Whether a question of legal tradition, of power balance between public authorities and private economic actors, or of accession time to the European Union, Member States of the Union have approached corporate governance very differently. The following overview explains the distribution of roles between the various actors currently involved in corporate governance schemes in the EU.

2.1 The emergence of corporate governance codes and comply-or-explain

The first phase of the institutionalisation of European corporate governance started in the early 1990s in the United Kingdom, at a time were the European Union comprised less than half of the current Member States. Following a number of local financial scandals, in 1992 the *Cadbury Report on the Financial Aspects of Corporate Governance* was released and became the first in a series of important guidelines that would come to be published in the European Union. Although the Cadbury Report cannot be considered as thorough as contemporary codes, it is nonetheless a milestone in European corporate governance history, as it was the first document to define a structure by which listed companies would be guided to adopt governance practices considered "best" by leading market participants such as professional associations, interests groups, stock exchanges, and governments.

Moreover, the Cadbury Report was the first set of corporate governance guidelines proposed to be applied on a "comply-or-explain" basis. According to this approach, companies were advised to voluntarily refer to the principles laid down in the Cadbury Report, and either adopt them or explain any deviations from these recommendations. This system, although implemented on a purely voluntary basis at the time of the Cadbury Report, was meant to encourage the adoption of best practices while guaranteeing companies the necessary flexibility with regard to governance practices. It was also praised for supplying a constant flow of information about the corporate governance practices of companies, which provided a foundation for further legislation[13]. The Cadbury Report may therefore be regarded as the cornerstone of the comply-or-explain framework in Europe, long before this system was introduced in European law[14].

Subsequently, a number of Western European Member States launched initiatives to set up similar codes of best practices for their markets in the late 1990s, although most are not based on a comply-or-explain approach. From 1995 to 1999, France, Spain, the Netherlands, Finland, Belgium, Italy, and Portugal adopted in succession sets of corporate governance guidelines that would come to lay the foundation of well-established corporate governance traditions in those Member States. As with the Cadbury Report for the United Kingdom, the aforementioned recommendations cannot, strictly speaking, be qualified as comprehensive codes of corporate governance *as such*: their scope was limited and they omitted a number of issues considered central to contemporary corporate governance. In addition, company attitudes would, in some Member States, lead to the neglect of these guidelines, which were in turn deprived of the necessary persuasiveness for such soft law instruments to have legitimacy in the eyes of market actors.

During the 2000s, in a second phase of institutionalisation, those Member States that had implemented first generation guidelines started adopting what would today be recognised as comprehensive codes of corporate governance. They were joined by a large number of Member States that directly adopted comprehensive corporate governance codes, building on other Member States' experience on the matter: between 2001 and 2005, 17 Member States adopted corporate governance codes, four of which had already implemented first generation guidelines[15]. The period coincides with a number of massive corporate scandals in Europe and around the world. For a number of Central and Eastern European Member States, the period also corresponds to the pre-

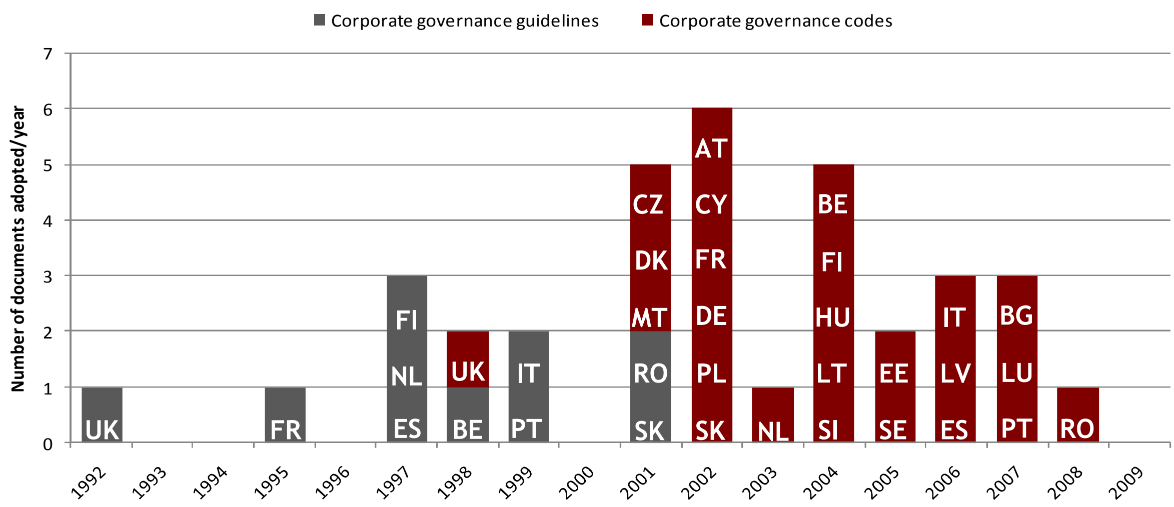
[13] Fasterling, *Best practices and Better Laws: Corporate Governance Codes in the Member States of the European Union*, ERA-Forum, Volume 6, Number 3 / September, 2005.

[14] The comply-or-explain approach was in 1992 incorporated in the listing rules of the London Stock Exchange. The United Kingdom was later on the first country to also adopt a mandatory application of the comply-or-explain reporting in 2000, via the listing rules of the Financial Services Authority, an authority created by the Financial Services and Markets Act.

[15] This figure does not take into account the earliest version of the "Combined Code", the first comprehensive code of corporate governance which had already been adopted in the United Kingdom in 1998.

accession effort to catch up with the EU acquis. The movement towards adoption of corporate governance codes lasted until 2007/2008, when codes were adopted in most of the remaining Members States, namely Luxembourg, Bulgaria and Romania. So far, a national corporate governance code may be identified in all EU Member States but two: Ireland (where the British "Combined Code" is applied)[16] and Greece (where a corporate governance law applies)[17].

Figure I-2-1: **Adoption of corporate governance guidelines and codes**



Corporate governance guidelines characterise preliminary initiatives which have been fully acknowledged by the market as providing a reference tool for companies in terms of corporate governance practices.
Corporate governance codes characterise initiatives which have been fully acknowledged by the market as providing a reference tool for companies in terms of corporate governance practices.

2.2 Different approaches to corporate governance codes

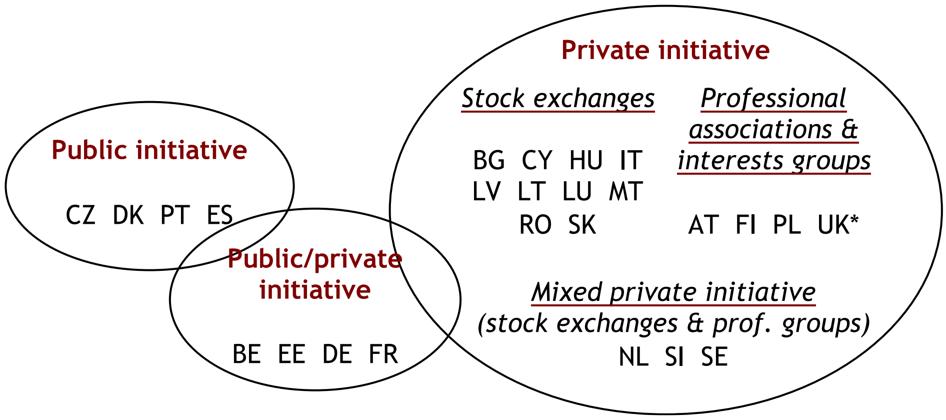
Although the British case can definitely be seen as a starting point for the spread of corporate governance codes in Europe, each Member State has its own traditions and its own approach to corporate governance, which has resulted in a veritable patchwork of practices when seen from a pan-European perspective. Corporate governance codes in the EU must therefore be seen in their own specific contexts. A number of tendencies can nevertheless be outlined.

Code drafters

First, a clear distinction can and should be made depending on the drafters of the code. Historically, the first national corporate governance codes were, to a significant extent, drafted as a result of initiative by national governments or through the collaborative efforts of public authorities and private actors. With time, the proportion of such government-driven initiatives decreased significantly, and an increasing number of corporate governance codes were primarily drafted by private actors, most notably by national stock exchanges. This evolution is particularly relevant for corporate governance codes of Central and Eastern-European Member States, amongst which ten out of twelve have been drafted by private actors (nine of which were drafted by local stock exchanges).

[16] A draft bill was proposed at the Irish Parliament on April 24th, 2009 by Labour Deputy Eamon Gilmore (opposition) to launch an Irish code of corporate governance for Irish companies, which would replace the British Combined code. The draft bill proposes to apply all provisions of the code on a mandatory basis, diverting from the comply-or-explain approach currently adopted at pan-European level.
[17] A number of initiatives have been launched in Greece and resulted in two white papers, the "Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation" (or Mertzanis Report) by the Committee on Corporate Governance in Greece (under the coordination of the Hellenic Capital Market Commission) in 1999, and the "Principles of Corporate Governance" of the Hellenic Federation of Enterprises and Industries (SEV), providing some corporate governance principles to corporations on a strictly voluntary basis. However, as these principles have never been officially endorsed and have not been followed by Greek corporations, Greece is commonly considered to have no comprehensive voluntary code of reference for corporate governance. Companies instead refer to a corporate governance law (Codified Law 2190/1920) and a decision of the Hellenic Capital Market Commission (Decision Nr. 5/204/14.11.2000).

Figure I-2-2: **Origin of the initial corporate governance code initiatives**



* 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.

The origin of the drafters of national corporate governance codes is particularly relevant when addressing monitoring and enforcement: as code drafters often tend to monitor and enforce code application, they have an important impact on the monitoring and enforcement tools, as will be described below.

Application of corporate governance codes

Another important difference in approach resides in the way corporate governance codes are applied across the European Union. Member States have taken quite different paths in order to impose the reference to corporate governance codes[18] as well as their application by way of comply-or-explain, as imposed by EU directive 2006/46/EC[19]:

- some Member States did not need to take any kind of legal or regulatory action, as the requirement to refer to the local code and apply it by way of comply-or-explain, was mandatory according to the local listing rules[20];

- in some Member States, listing rules do not even need to specify that the code needs to be applied by way of comply-or-explain, as the codes itself mentions it[21];

- in some Member States, a mix of public and private regulation applies. Commonly, listing rules impose reference to the local corporate governance code (and sometimes require a compliance statement, without mentioning any method), and the law or securities regulation imposes the comply-or-explain approach[22];

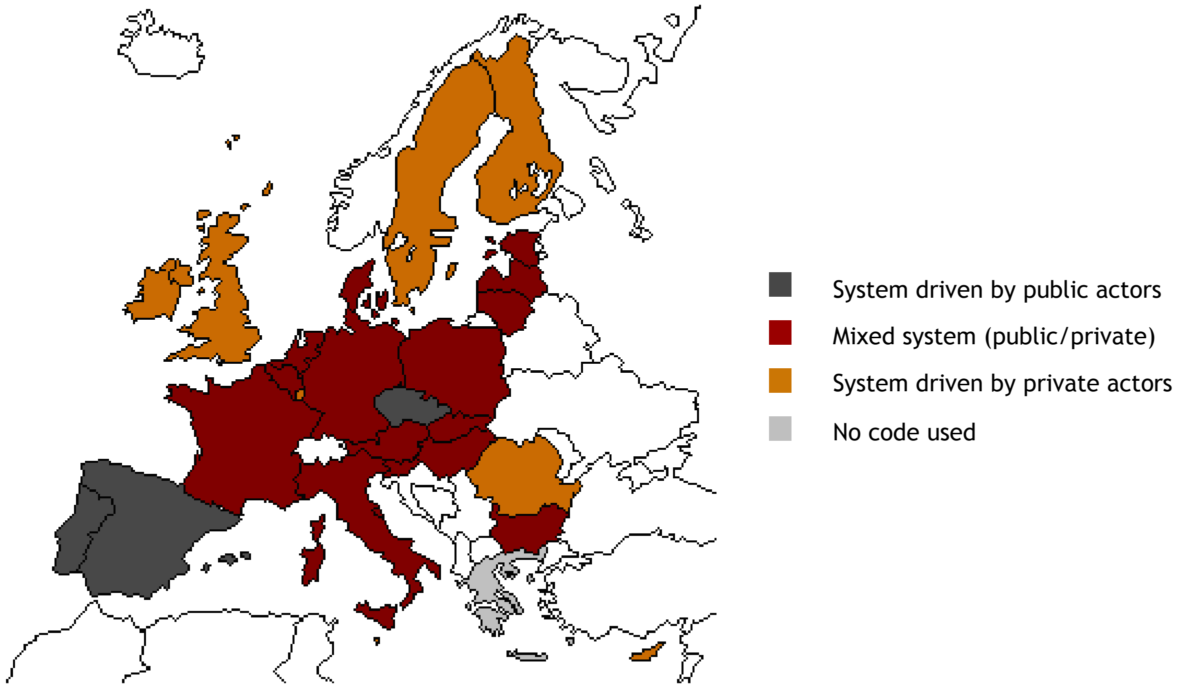
- some Member States have chosen to impose the whole system, meaning the reference to the code and its application by way of comply-or-explain, by law or regulation[23].

Although it seems that corporate governance codes drafted by public authorities, for the most part, tend to be imposed by legislation or regulation, a similar parallel cannot be drawn for codes that have been drafted by private actors or via a public/private initiative. A variety of combinations may

[18] As an alternative, Directive 2006/46/EC offers the possibility for Member States to allow companies to report on self-defined corporate governance principles which however need to be made public.
[19] Directive 2006/46/EC of the European Parliament and of the Council dated June 14th, 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings; available at: http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_224/l_22420060816en00010007.pdf
[20] This is the case in Denmark, Ireland, and Romania.
[21] This is the case in Cyprus, Estonia, Finland, Luxembourg, and Sweden.
[22] This is the case in Austria, Bulgaria, Italy, Latvia, Lithuania, Poland, Slovakia, and Slovenia, and the United Kingdom (the FSA listing rules are considered securities regulation for the purpose of this Study).
[23] This is the case in Czech Republic, France, Germany, Hungary, the Netherlands, Portugal, and Spain.

therefore be observed among Member States, and less than a dozen of the Member States' corporate governance code systems are organised around one single actor, be it public or private.

Figure I-2-3: **Categorisation of corporate governance systems**



2.3 Content and structure of European corporate governance codes

Corporate governance codes do not only differ in application, but also in content. A detailed overview of the content of codes versus that of the law will be given later, but some tendencies may already be observed.

The level of detail of corporate governance codes highly differs from one Member State to the next. Some codes comprise guidelines corresponding to different levels of obligation; most commonly, this type of code comprises three levels of guidelines: *general principles*, which are usually mandatory for companies (sometimes drawn from the law); these principles can guide a larger number of *recommendations*, that have to be applied by way of comply-or-explain; finally, this type of codes may also contain *suggestions*, which usually indicate how to apply the recommendations, or provide some best practices as examples, comply-or-explain commonly does not apply to these *suggestions*[24].

In certain other instances, corporate governance codes provide for a different implementation of the code depending on the size of the company; this may materialise in the form of fewer applicable recommendations for smaller companies, as in Austria, Ireland, Slovakia, or the United Kingdom. Codes may also provide that the obligation to apply the recommendations by way of comply-or-explain is a requirement only for companies listed in the highest listing compartment, like in Bulgaria. Bulgarian companies listed in lower compartments are only advised to implement the code, which then functions as a simple set of suggestions to those companies.

In a large number of cases, codes provide for a single type of recommendation applicable to all companies. This category is, however, much less homogeneous than the aforementioned examples, as the level of detail of the recommendations varies significantly from one code to the other. The

[24] This typology is used in Belgium, Denmark, Germany, Hungary, Italy, Luxembourg, Slovenia, and Sweden. A number of other Member States use similar, though less developed, typologies in terms of level of importance of the guidelines contained in the codes.

recommendation to have a certain number of independent directors on the board of a company is a good example to show how extensively the level of detail of codes can vary. First, regarding the definition of independence, the number of criteria used to qualify a board member as independent is very diverse. In some codes, it may comprise a dozen criteria or more[25], while in others, the number of criteria and the level of precision of those criteria may be less extensive[26]. Finally, some codes might strictly define independence as the absence of conflict of interest, without guidelines to assess this absence[27]. Then, on the recommendation to include independent directors on the board, the guideline may be as prescriptive as requiring a precise number or percentage of independent directors (up to requiring independence for the entirety of the board[28]), it may also mention a minimum proportion, and the code may finally request “an adequate number” (of independent directors) that each company would decide upon[29].

Having considered each of these different methods, the main conclusion is that the technique according to which corporate governance codes are built does not prejudice their level of detail. Codes with different levels of guidelines can be very detailed and very prescriptive, like the Hungarian code, or much less detailed and prescriptive, like the Luxembourg code. Codes with a single set of recommendations may be very detailed and prescriptive, like the Dutch code; some might be quite detailed but less prescriptive, like the French code; some might be slightly less detailed but still quite prescriptive like the Spanish code; and some might be less detailed and less prescriptive, like the German code.

This observation should not be regarded as a ranking of the quality of corporate governance codes from one Member State to the other. First, because corporate governance codes should be seen within their own legal framework: the level of detail and the comprehensive aspect of a corporate governance code are only relevant when compared to the level of detail of local law, i.e. the room left to soft law initiatives by local regulation and legislation. Second, the level of detail of a code has to be analysed in relation to the attitude of companies on the one hand, and the objective of the code on the other hand. In order for those elements to be in accordance with each other, i.e. to fulfil the objective set by the corporate governance code, the application of the code needs to be effectively monitored and the recommendations need to be adequately enforced.

2.4 Ownership structures in the European Union

Finally, going beyond the strictly legal aspect of the corporate governance framework in Member States, some important differences between national corporate governance codes may find their origins in the ownership structures of companies in the various Member States. British and Irish listed companies often have quite dispersed ownership structures, whereas ownership is very concentrated in Italy, Austria, Germany, Portugal, and the Baltic Member States. France and the Netherlands, although not at the level of the United Kingdom, have quite low levels of ownership concentration, and the Nordic Member States, as well as Belgium and Slovenia, lie in an intermediate position.

The nature of ownership is also quite diverse: block holders in listed companies are more typically individual or family shareholders in Mediterranean Member States and Belgium; non-financial institutions (private companies, foundations) in Bulgaria and Estonia; a mix of non-financial institutions and family ownership in Germany; and financial institutions in Austria, France, and the Netherlands, and to an even greater extent in the United Kingdom. In Eastern Europe, a significantly high proportion of ownership remains concentrated in the hands of public institutions[30].

The origin of the ownership is also noteworthy. In a number of Member States, stock ownership is mainly concentrated in the hands of foreign investors[31], whereas some Member States, such as Bulgaria, Cyprus, Denmark, Germany, Italy, Slovenia, and Spain, rely on a significant domestic

[25] In Belgium, France, Lithuania, the Netherlands, Poland, and the United Kingdom for example.
[26] In the Czech Republic, Finland, Hungary, Malta, and Slovenia for example.
[27] In Germany for example.
[28] In the Czech Republic, and in the Netherlands (with a tolerance for at most one non-independent board member).
[29] Notably in Bulgaria, Germany, Hungary, Italy, and Luxembourg.
[30] Notably in Lithuania, Slovenia, and, to a lesser extent, in Poland.
[31] Notably in Ireland, Finland, Hungary, the Netherlands, and Slovakia.

ownership. France, Sweden, and the United Kingdom remain around the European average with about 40 percent foreign ownership.

These differences in ownership give shareholders and institutional investors a greater or lesser degree of influence in the field of corporate governance, notably in their role of monitoring company practices and enforcing corporate governance codes[32].

2.5 Comply-or-explain at European level

Despite the divergence of corporate governance practices amongst EU Member States, after having undertaken a comparative study of corporate governance codes in Member States[33], the European Commission reached the conclusion, at that point, that a uniform corporate governance code should not be adopted. Instead, it was decided to harmonise not the substance but rather the codes' enforcement mechanisms; in other words to promote the EU-wide application of the comply-or-explain approach.

Directive 2006/46/EC introduced the requirement for companies with securities traded on a regulated market[34] to publish a corporate governance statement. The statement shall contain at least a reference to the code that the company is subject to and/or to the code which the company may have voluntarily decided to apply, and/or all relevant information about the corporate governance practices applied beyond the requirements under national law. Companies shall indicate where the code texts are publicly available and make their other corporate governance practices publicly available. The Directive does not determine the minimum quality and content of the reference corporate governance code.

Additionally, companies shall provide information on a series of topics, including:

- internal control and risk management systems in relation to the financial reporting process,
- antitakeover bid measures,
- procedures and key powers of shareholder meetings, including a description of shareholder rights and how they can be exercised,
- composition and procedures of administrative, management, and supervisory bodies, as well as their committees.

Although the concept of comply-or-explain has already been in place in many EU Member States, the Directive makes the use of the comply-or-explain method mandatory[35] and introduces a number of new requirements which had not been harmonised among Member States so far.

First, companies are required to include a corporate governance statement in a specific section of their annual report. Alternatively, Member States may permit the corporate governance statement to be set out in a separate report, published together with the annual report or by means of a reference in the annual report when such a document is publicly available on the company's website.

[32] More on the subject in: Federation of European Securities Exchanges, *Share ownership structures in Europe, Study by the Federation of European Stock Exchanges*, dated December 2008; available at: http://www.fese.eu/_lib/files/Share_Ownership_Survey_ 2007_Final.pdf.
[33] Weil, Gotshal & Manges LL.P., *Comparative Study of Corporate Governance Codes Relevant to the European Union and Its Member States*, 2002, available at http://ec.europa.eu/internal_market/company/docs/corpgov/corp-gov-codes-rpt-part1_en.pdf.
[34] According to the article 4 Article 4(1), point (14) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments the 'regulated market' means a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third party buying and selling interests in financial instruments – in the system and in accordance with its nondiscretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorized and functions regularly and in accordance with the provisions of Title III of the Directive.
[35] See footnote 18.

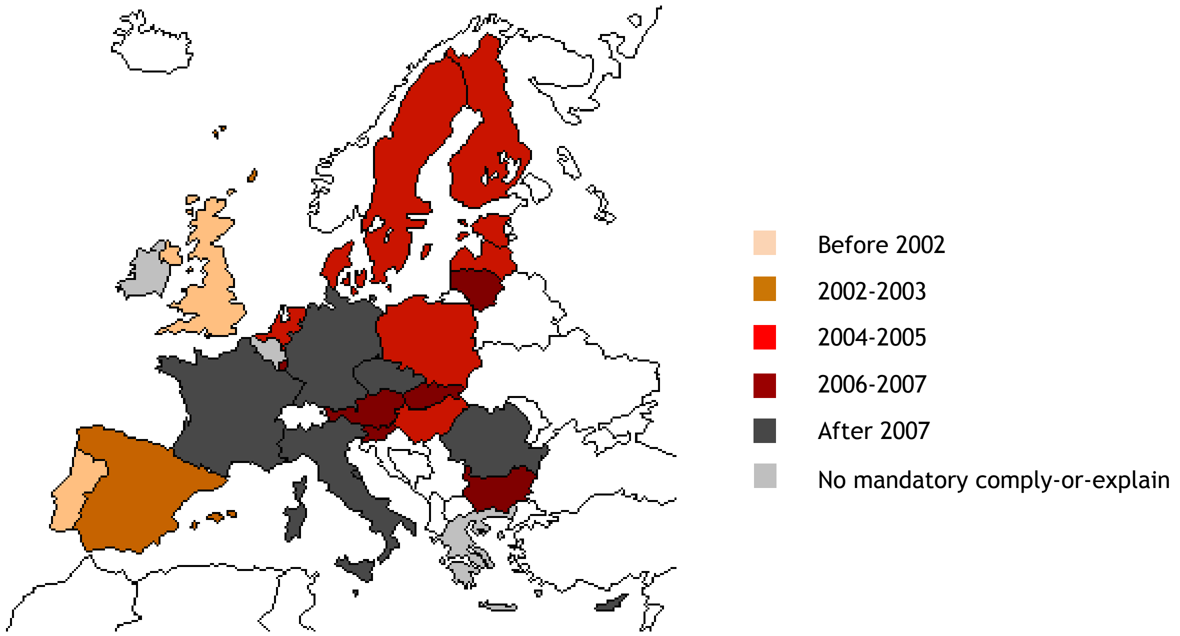
Second, the Directive imposes the requirement for statutory auditors to check that the corporate governance statement has been produced. This obligation applies both when the statement is included in the annual report and when it is published separately.

Finally, the Directive imposes the legal duty on members of the administrative, management, and supervisory bodies of companies to ensure that the annual accounts, the annual report and, when provided separately, the corporate governance statement are drawn up and published in accordance with the requirements of the Directive and international accounting standards, where applicable. The breach of such duty should entail the liability of the members of the administrative, management and supervisory bodies, at least towards the company.

2.6 Implementation of Directive 2006/46/EC by the Member States

Directive 2006/46/EC provided Member States with discretionary choices as to how to implement legal requirements to adopt the comply-or-explain mandate[36]. The requirement to publish a corporate governance statement on a comply-or-explain basis contained in the Directive has, in practice, been implemented either by law[37], securities regulation[38] or listing rules[39], or by reference of either of these instruments to such a requirement already existing in the code itself[40]. A number of Member States had already adopted this approach long before the implementation deadline set on September 5th, 2008. However, as of the drafting date of this Study, three Member States, Belgium, Greece, and Ireland, had not yet implemented the Directive[41].

Figure I-2-4: **Adoption of a mandatory comply-or-explain scheme**



The application of the corporate governance code on a comply-or-explain basis is accepted by non-EU markets as well. For example, the New York Stock Exchange allows non-U.S. companies not to apply its governance standards if they provide the Exchange authorities with a written certification

[36] See footnote 18.
[37] The Directive has been implemented this way in Austria, Bulgaria, the Czech Republic, France, Germany, Hungary, Latvia, Lithuania, the Netherlands, Slovakia, Slovenia, and Spain.
[38] This is the case in Portugal and the United Kingdom.
[39] This is the case in Denmark, Estonia, Ireland, Italy, Latvia, Poland, and Romania.
[40] This is the case in Cyprus, Finland, Luxembourg, and Sweden.
[41] Maltese authorities were still undertaking consultation for the implementation of the directive by the drafting date of this document. They communicated transposition in July 2009, which is taken into account on this figure but has not been thoroughly analysed.

from independent counsel of the company's country of domicile stating that the company's corporate governance practices comply with home country law and the rules of the principal securities market for the company's stock outside the United States. In this case, the declaration stating that the company applies the code by way of comply-or-explain is sufficient for the company to take advantage of this exemption.

2.7 Complex listing situations

Directive 2006/46/EC does not contain any rule or recommendation in case of conflicting obligations, or lack thereof, in the framework of the comply-or-explain system. Indeed, as mentioned previously, Member States have implemented the comply-or-explain approach through different instruments, which resulted in discrepancies of universes of companies covered by the requirement. The situation may get complicated for companies with complex listing situations, i.e. which are not (or not only) listed in their Member State of incorporation.

For instance, in the Netherlands, the requirement to adopt the comply-or-explain approach vis-à-vis the Dutch corporate governance code is a legal requirement applicable to all Dutch companies listed on a regulated market, wherever this market may be. Inversely, in the United Kingdom, the requirement to adopt the comply-or-explain regime in relation to the British Combined Code is laid down in the British listing rules, and applies to all companies listed in the United Kingdom, whatever their Member State of incorporation may be. Hence, a Dutch company only listed in the United Kingdom would have to apply both the Dutch code (due to its incorporation in the Netherlands) and the British code (due to its listing in the United Kingdom). Conversely, a British company only listed in the Netherlands is theoretically in a situation where it is not bound by any obligation to apply either the Dutch or British code by way of comply-or-explain[42].

Few Member States have laid down provisions to remedy such situations. However, practice shows that circumstances where a company faces a situation where it is not legally bound to apply any code by way of comply-or-explain are fairly scarce[43]. More common is the situation of companies with multiple listings (usually in their country of incorporation and in one or more markets of strategic importance for the company). In such cases, practice shows that companies themselves chose one code of reference (often the code of the country of incorporation), according to which they report with the comply-or-explain approach. Compliance with and deviations from the other codes are usually more briefly described[44]. There has been, to the best of our knowledge, a fairly limited number of “forum shopping” situations, where a company would pick and choose the provisions of different codes to suit its needs.

To solve this issue in a formal way, the European Corporate Governance Forum proposed, on March 23rd, 2009, to introduce a set of new rules[45]:

- In case the Member State of registered seat and the Member State of the primary listing are different, the company should choose a corporate governance code applied in either the Member State of its registered seat, or the Member State of its primary share listing.

- A Member State can only require that a company that is either registered in that Member State or the shares of which are admitted to trading on a regulated market in that Member State, but which applies another Member State's corporate governance code explains in

[42] Note that this example remains theoretical, as the UK Financial Services Authority set some rules striving to regulate this type of situations.

[43] Except for Greek companies, due to the absence of code of reference and comply-or-explain regime in Greece, but a corporate governance law applies.

[44] Often observed is a reporting in the same form as the compliance statement to the New York Stock Exchange listing rules for foreign issuers. Thanks to the long but fruitful equivalence negotiations between the European Commission and the Stock Exchange Commission in the United States, non-compliance with the (mandatory) NYSE listing rules is allowed for non-US issuers when a legal or code provision in the country of primary listing conflicts with the NYSE rule. The same approach, also laid down in the UK Listing Rules, is often adopted here, where companies highlight the areas of non-compliance with the second or third applicable code, based on contradictory code provisions vis-à-vis their main code of reference.

[45] *Statement of the European Corporate Governance Forum on Cross-border issues of Corporate Governance Codes*, dated March 23rd, 2009; available at: http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf-crossborder_en.pdf.

what significant ways the actual corporate practices of that company deviate from those set out in the Member State's corporate governance code.

A company with cross-border share listing would have the freedom to choose which potentially applicable code it wishes to apply, in light of its own particular circumstances, but would have the obligation to choose one. At the same time, it would avoid the double application of two potentially applicable codes, by simply explaining areas of non-compliance with other potentially applicable codes. The proposed rules also provide a solution for companies confronted with a situation where no code is applicable to them, as they would also have to choose one code of reference.

Finally, as the issue of complex listing situations should not be restricted to a European viewpoint, the application of corporate governance rules is not based everywhere on codes applied by way of comply-or-explain. However, the comply-or-explain approach is quite widely accepted by non-EU markets as well. Indeed, a large number of non-EU markets accept that companies deviate from their listing rules or local governance codes because they follow one of the European national corporate governance codes by way of comply-or-explain. This is the case, for example, on the New York Stock Exchange[46] or on the Oslo Stock Exchange in Norway[47].

[46] See footnote 44.
[47] According to the *Continuing obligations of stock exchange listed companies of the Oslo stock exchange*, companies "must provide a report on [their] corporate governance in the annual report. The report must cover every section of the Code of Practice. […] The report may be prepared in accordance with the equivalent code of practice applicable in the state in which the company is registered or in the company's primary market. If there is no such code of practice or if the company does not use such code of practice, the report must be prepared in relation to the Norwegian Code of Practice for Corporate Governance"; http://www.osloaxess.no/oax_eng/content/download/6161/378341/file/Continuing_obligations_of_stock_exchange_listed.pdf.

3 RELATION BETWEEN LEGISLATION AND CODES: RULES APPLYING TO COMPANIES

Following the research of the Comparative Study of Corporate Governance Codes[48], the European Commission published a Communication to the Council and the European Parliament in May 2003, proposing an EU-wide Action Plan to modernise company law and enhance corporate governance[49]. The European Commission set out four main objectives:

- The enhancement of disclosure,
- The reinforcement of shareholder rights,
- The modernisation of boards of directors, and
- The coordination of corporate governance efforts of Member States.

As the European Commission has to a greater extent worked on the first and fourth objectives, with the adoption of Directive 2006/46/EC and the creation of the European Corporate Governance Forum respectively, some elements of the second and third objectives have so far been left untouched. This sub-section will therefore focus on the modernisation of boards of directors (including audit, internal control and risk management), while sub-section 4 will tackle the issue of shareholder rights and responsibilities.

3.1 Composition and functioning of boards of directors and supervisory boards

As mentioned above, alongside other targets, the modernisation of boards of directors was quoted as one of the four main corporate governance-related objectives of the Action Plan. As part of the Action Plan, the European Commission also presented the type of action the Union was intending to take in order to reach the objectives of the Plan. As foreseen, and following a public consultation over the summer of 2003 and the European Parliament's approval in April 2004, the Commission adopted a Recommendation in February 2005 to clarify the role of boards of directors and committees[50]. The Recommendation, aimed at eliminating and preventing conflicts of interests within boards of directors, contains six main pillars:

- An appropriate balance of executive and non-executive directors on boards, including a separation of the functions of chairman of the board and chief executive officer (CEO);
- A sufficient number of independent directors on boards, as well as adequate disclosure on the determination of board members' independence;
- The creation of board committees, which should mainly comprise independent non-executive directors;
- The regular evaluation of the board's functioning and competence;
- An enhanced transparency and communication from companies towards shareholders on boards' activities;
- A clarification of standards of qualification, competence, and availability for board members.

Member States were invited to take the necessary measures to promote the application of the Commission Recommendation by June 30th, 2006, either through legislation or through best practice

[48] See footnote 33.

[49] Communication from the Commission to the Council and the European Parliament, *Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward*, COM (2003) 284, dated May 21st, 2003; available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2003:0284:FIN: EN:PDF.

[50] Commission Recommendation on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, 2005/162/EC, dated February 15th, 2005; available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2005:052:0051:0063:EN:PDF.

rules. In 2007 the Commission published a Report on the application of the Recommendation in 21 Member States[51].

The Reports highlights the fact that most Member States implemented the principles of the Recommendation in their codes of corporate governance. Still, the Report notes that some provisions have not been implemented in some Member States or applied by companies due to the possible absence of requirements to comply-or-explain at the time[52]. The following analysis builds on the EU Commission's Report and complements it in a number of ways: by extending the spectrum of issues tackled, by giving an updated picture of the corporate framework as of June 2009, and, finally, by extending the geographical coverage to all 27 EU Member States.

3.1.1 Board structure and elections

The Commission Recommendation did not start from scratch when drafting guidelines on boards of directors. Contrary to other domains of corporate governance, rules and principles relating to boards of directors are quite deeply anchored in general company law. In all 27 Member States, the basic organisational rules are to be found in legislative or regulatory instruments.

First of all, the choices for companies to adopt a certain board structure for listed companies (unitary or dual, both possibilities, or even "hybrid") are almost always laid down in the law: nine Member States foresee unitary structures, eight foresee dual structures, another seven foresee both, and two Member States, Italy and Hungary, allow what can only be called "hybrid" structures – in Hungary for instance, the distinction between the two boards does not follow the usual non-executive/executive distinction, as non-executive members may sit on the management board. Lithuania is the only exception to the rule, and should be highlighted due to the fact that it is the only Member State in the European Union where there is no formal obligation to establish a board of directors. Local practice, however, shows that publicly listed companies do set up boards, and that both the unitary and dual structures are used.

The election and dismissal process for board members is also a strictly regulated matter across the Union. The law designates the general meeting of shareholders as the supreme decision making body that is primarily responsible for the election of board members. In a number of Members States though, legal rules mandate employees' right to elect their own representatives to the board without the general meeting having any control of that decision as soon as the company reaches a certain size in terms of employee headcount. This is notably the case in Nordic[53] or Germanic[54] Member States, as well as some other Member States with strong Germanic influence on their legal framework[55]. The dismissal of board members is also a publicly regulated issue across Member States. The general meeting is again the body of reference, which has the power to dismiss the board members it appointed, sometimes with a stronger majority requirement[56]. Board members directly appointed by employees may only be dismissed by the latter.

3.1.2 Board composition

As far as the composition of boards is concerned, the rules of reference are more diverse. The size of the board is often regulated by law. Legislation or regulation frequently foresees a minimum number of 3 board members. The maximum size often varies, and is also fluctuating in a number of Member States depending on the presence of employee representatives on the board (including in Member States where such representation is not mandatory). The presence of non-executive members on the board is subject to very different types of rules. The issue is, first of all, not

[51] Commission Staff Working Document, Report on the application by the Member States of the EU of the Commission Recommendation on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, SEC (2007) 1021, dated July 13th, 2007, available at http://ec.europa.eu/internal_market/company/docs/independence/sec20071022_en.pdf. Bulgaria, Cyprus, the Czech Republic, Portugal, Romania and Spain were not covered by the Report.
[52] The transposition of the Directive 2006/46/EC in September 2008 at the latest probably changed this observation.
[53] Denmark, Finland, and Sweden.
[54] Austria and Germany.
[55] Czech Republic, Slovakia, and Slovenia.
[56] In Austria and Slovenia for instance, a majority of ¾ of the votes is required to dismiss a board member before the end of his/her term.

relevant in Member States that only allow dual board structure for listed companies, as supervisory boards comprise, per se, only non-executive board members[57]. Apart from this situation, rules on the issue may be found in codes as much as in the law. In most cases, a proportion of non-executive board members is recommended or requested (either 33 or 50 percent); in some instances, an "adequate number" (of non-executive directors) is referred to. The case of Sweden should be highlighted, where the corporate governance code recommends that no more than one board member should be an executive.

The topic of independence of board members is mainly dealt with in corporate governance codes. In most Member States, there is nothing to find in the law on the issue[58]. Independence is indeed a soft law topic, which, as mentioned above, the European Commission identified as one of the main pillars of its Action Plan. Codes for the main part either recommend a specific proportion of independent members on the board (either 33 or 50 percent), or an "adequate number". Less than 20 percent of corporate governance codes recommend a specific number of independent board members, among which the Dutch code recommends that all supervisory board members be independent except one. This categorisation does not prevent codes from giving companies a fairly high degree of flexibility. For instance, the British code generally recommends at least 50 percent independence on the board, with the exception of smaller companies, for which it recommends that at least two board members be independent. In France, the code's flexibility in this regard depends on the presence of a significant shareholder, in which case the recommended independence quotient of the board is lowered from 50 to 33 percent. In Greece, the law requires a minimum of two independent board members, but allows companies to replace those with representatives of minority shareholders. A small number of codes also recommend the determination of a senior independent director to lead the other independent members within the board[59].

Although corporate governance codes - and legislation in the rare cases of a legal definition of independence - present different guidelines on the necessary independence quotient, the main difference between Member States lies in the definition of independence. In its 2005 Recommendation, the Commission defined independence as the situation where a board member is, "free of any business, family or other relationship, with the company, its controlling shareholder or the management of either, that creates a conflict of interest such as to impair his judgement." In addition, Annex II of the Commission Recommendation contains a number of criteria intended to guide definitions at Member State level. Code drafters or legislators in Member States were subsequently left to define their own concept of independence. In most instances, this was done by using exclusionary criteria on the model of Annex II of the Commission Recommendation, i.e. by screening out the occurrences when a board member would not be considered independent. Such a technique has been used in most codes[60] as well as in the few legal definitions of independence[61]. This naturally leads to quite diverse definitions, which take local specificities into account, but which also take more or fewer criteria in consideration. In some other instances, a general definition was given and reference was made to the criteria proposed in Annex II of the Commission Recommendation[62]. The last option taken in some Member States was to keep a general definition without referring the Annex II, and leaving to companies the task of creating their own definition of independence[63].

This great diversity in the types of definition, and within those types, in-between the definition themselves, naturally leads to discrepancies in the stringency of independence definitions from one Member State to the other. In Finland and Sweden, corporate governance codes even differentiate between two types of independence: independence from the company, and independence from shareholders (and the company). From definitions strictly referring to the avoidance of conflict of interest to definitions taking more than a dozen criteria into consideration, the topic of independence shows the flexibility of the system in areas where the Commission deliberately chose

[57] Note that in Denmark and Finland, supervisory boards may include executive members.
[58] Except in Belgium, Bulgaria, Greece, and Romania.
[59] This is notably the case in Cyprus, the Netherlands and the United Kingdom.
[60] In Belgium, Cyprus, Denmark, Finland, France, Hungary, Italy, Latvia, Lithuania, the Netherlands, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom.
[61] In Belgium, Bulgaria, Greece and Romania.
[62] In Luxembourg and Poland.
[63] In Austria, the Czech Republic, Malta and Germany.

not to regulate[64]. Still, the concept of independence and the importance to have a well balanced board with a number of independent members has been acknowledged in all Member States.

One final issue concerning the independence of board members which still shows important differences among Member States is the transparency in terms of independence qualification. The requirement or recommendation to indicate which board member is independent (or not) and according to which criteria, is not in place everywhere in the Union and not always followed precisely[65]. The issue is, however, monitored, as shown by the 2007 Commission Report on the application of the Recommendation[66].

The following table summarises some key elements of independence definitions to be found in corporate governance codes throughout the EU:

[64] See 2003 Action Plan (see footnote 49).
[65] This is notably the case in Central and Eastern-European Member States with a more recent corporate governance tradition.
[66] See footnote 51.

Figure I-3-1: **Elements of code definitions of independence in the Member States**

The code definition of independence* excludes board members matching the following criteria (among others):	AT	BE	CZ	CY	DK	EE	FI	FR	IT	HU	LV	LT	LU	MT	NL	PL	RO	SI	SK	ES	SE	UK/IE
- executive or managing director of the company or an associated company	yes	yes	no	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	no	yes	yes	yes	no	yes	yes	yes	yes
cooling off period	5	3		1	no	3	3	5	3	no	3	5	5		5	5	5		5	5	5	5
- employee of the company or an associated company	yes	yes	yes	no	yes	yes	yes	yes	yes	yes	yes	yes	yes	no	yes	yes	yes	yes	yes	yes	yes	yes
cooling off period	5	3	no		5	no	3	5	3	no	no	3	3		5	3	5	no	3	3	3	5
- receiving, or having received, significant additional remuneration from the company or an associated company, apart from fees received as non-executive director	no	yes	no	no	yes	yes	no	no	yes	no	yes	yes	yes	no	yes	yes	yes	no	yes	yes	yes	yes
cooling off period		no			no	no			3		no	no	no		no	no	no		no	no	no	no
- controlling shareholder or director of such a shareholder	no	yes	no	yes	yes	yes	yes	yes	yes	no	yes	yes	yes	no	yes	yes	yes	no	yes	yes	no	yes
cooling off period		no		no	no	3		5	no		no	no	no		no		no		no	no		no
proportion of shareholding		10%		no	majority	no	10%	10%	no		no	majority	10%		10%	5%	10%		no	3%		no
- controlling shareholder or executive officer of such a shareholder	no	yes	no	yes	yes	yes	no	yes	yes	no	yes	yes	yes	no	yes	yes	yes	no	yes	yes	no	yes
cooling off period		no		no	no	3		no	no		no		no		no		no			no		no
proportion of shareholding		10%		no	majority	no		10%	no		no	majority	10%		10%	5%	10%			3%		no
- significant business relationship with the company or an associated company	yes	yes	no	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes
cooling off period	1	yes		no	no	1	no	5	1	no	1	1	1	no	yes		1	no	no	no	no	3
- partner or employee of the current or former external auditor of the company or an associated company	yes	yes	no	yes	no	yes	no	yes	yes	no	yes	yes	yes	no	yes	Yes	yes	no	yes	yes	yes	yes
cooling off period	3	3		no		3		5	no		3	3	3		1	3	3		3	3	3	3

* In Bulgaria, Germany, and Portugal, there is no definition of independence in the code; in Greece, there is no reference corporate governance code.

The code definition of independence* excludes board members matching the following criteria (among others):	AT	BE	CZ	CY	DK	EE	FI	FR	IT	HU	LV	LT	LU	MT	NL	PL	RO	SI	SK	ES	SE	UK/IE
- executive or managing director of another company in which an executive or managing director of the company is a non-executive or managing director (and other significant links with executive directors of the company through involvement in other companies or bodies) - Interlocks	yes	yes	no	no	no	no	no	yes	yes	no	yes	yes	yes	no	yes	yes	yes	no	no	yes	yes	yes
- having served on the board as a non-executive director for more than	no	yes	no	no	no	yes	no	yes	yes	no	yes	yes	yes	no	no	yes	yes	no	yes	yes	yes	yes
years		no				10		12	9		10	12	12			12	no		15	12	12	9
terms		3				no		no	3		no	no	no			3	3			2	no	3
- close family member of an executive or managing director, or close family member of a director in one of the situations described above	yes	yes	yes	yes	yes	yes	no	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes	yes
- temporarily managed the company	no	no	no	no	no	no	no	no	no	no	no	no	no	no	yes	no	no	no	no	no	no	no
- corporate officer of a company in which the company holds, either directly or indirectly, a directorship, or in which a directorship is held by an employee of the company designated as such or by a current or former corporate officer of the company	no	no	no	no	no	yes	no	yes	no	no	no	no	no	no	no	yes	no	no	no	yes	no	no
cooling off period						no		5				no								no		
- entitled to any fees as a board member that are dependent on the company's performance or to any share options	no	no	no	no	no	no	no	no	no	no	no	no	yes	no	no	yes	no	no	no	no	no	yes
- other catch all provision	no	no	no	yes	yes	no	no	yes	no	yes	no	yes	no	yes	no	no	no	no	yes	no	no	no

* In Bulgaria, Germany, and Portugal, there is no definition of independence in the code; in Greece, there is no reference corporate governance code.

3.1.3 Mission, functioning of the board and reporting

The mission statement of boards is mainly dealt with by legislation and regulation, although most corporate governance codes also touch on the subject. The main distinction here is between unitary and dual board structures. In dual board structures, the mandate of the supervisory board is to oversee the activities of the management board; both bodies have fairly strictly defined functions within a company. This clear distinction may however become somewhat blurred when the local legal and/or code framework does not make such a clear distinction between the role of the two boards, like in Italy and Hungary, or even in Denmark or Finland. For unitary board structures, the board mixes a supervisory role (which is then shared with the general meeting) and managerial tasks (due to the presence of executive directors on the board). Such general mission statements are regulated matters, whereas codes detail those tasks in more detail, without bringing significant addition to the law.

In other cases, as far as the functioning of board is concerned, corporate governance codes usually add a noteworthy input to suite incomplete legal provisions on the issue: *inter alia*, codes may provide for recommendations in terms of frequency of meetings, on decision making, their relationships with the management, and with the general meeting. Codes mainly transpose the principles set by the law in terms of mission into functioning guidelines.

One important element of functioning rules is the evaluation of the board’s activity. Although not a legal requirement in all 27 Member States, the evaluation of the board’s activity, through either self-evaluation or third-party assessment, has made its way into codes quite extensively. The self-evaluation of board activities is now part of a majority of corporate governance codes[67], although some only target the evaluation by the supervisory board of the management board’s activity (in dual board structures)[68].

Finally the reporting of the board’s activities is a subject traditionally tackled by corporate governance codes. These code recommendations, in connection with the implementation of Directive 2006/46/EC that, in most cases led Member States to legally require the inclusion of a corporate governance statement in annual reports, have made the reporting of board activities a strong element of European corporate governance. Although the level of detail of such reporting may vary from company to company[69], the practice of reporting on the board’s activity is now well anchored across the Union.

3.1.4 Board committees

In order to facilitate board functioning, especially in bigger companies, corporate governance codes have for a number of years been recommending the establishment of committees within the board, to help the latter perform certain sensitive tasks[70]. These recommendations mainly focus on three domains: audit of the company’s accounts, remuneration of executive officers, and selection of board members and executive officers.

The recommendation to set up committees is laid out differently in corporate governance codes, from clear recommendations to set up three committees[71], to recommendations to set up committees in the three domains[72], to simple suggestions to set up committees when deemed necessary or on certain issues only[73], to mere authorisations to introduce committees[74].

[67] Except in Austria, Cyprus, Germany, and Malta. In the Czech Republic, Latvia, and Portugal, the subject is covered by legal provisions.
[68] In Bulgaria, Denmark, and Estonia.
[69] Regarding reporting, differences are more notable between companies of a same Member States than between different Member States.
[70] The Maltese code is the only corporate governance code which does not make any reference to board committees.
[71] In Austria, Belgium, Cyprus, Finland, France, Lithuania, Luxembourg, the Netherlands, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.
[72] In the Czech Republic, Germany, and Hungary.
[73] In Bulgaria, Denmark, Italy, Latvia (audit only), Poland (audit at least), and Portugal (audit and remuneration only).
[74] In Estonia.

Audit committees

The establishment of audit committees was originally the province of corporate governance codes. Audit committees are to monitor financial reporting and accounting procedures, as well as to liaise with statutory auditors on these issues. Regarding the audit committee composition, codes very often recommend the inclusion of sufficient financial expertise, usually in the form of one financial expert on the board[75], and usually raise the recommended levels of non-executive and independent board members as compared to those concerning the board at large (if any).

The aforementioned 2005 Commission Recommendation advocated for the creation of audit committees and already detailed some key elements of their suggested composition, role and functioning[76]. Since Directive 2006/43/EC[77], the existence of audit committees, one of the pillars of code-based governance, has made its way into European hard law via the obligation to establish an audit committee in listed companies across the Union. The choice is also given to Member States to allow a waiver to the establishment of audit committees when similar structures responsible for monitoring financial reporting and accounting are in place, or to allow the board as a whole to take this function.

According to European legislation, audit committees shall comprise, strictly, non-executive board members, and at least one member who would both be independent and have financial expertise. In cases when the board as a whole performs the duties of the audit committee, the chairman of the board may not chair the audit committee if he/she is also an executive director.

Member States have for the most part transposed the provisions of the Directive into their own legislation, and in some cases into securities regulation[78]. However, a number of Member States have not yet implemented the Directive in their own national frameworks. As of the drafting date of this Study, Austria, Estonia, Italy, Ireland, and Luxembourg were still lacking a formal transposition of the Directive[79]. The Scoreboard of the European Commission on the transposition of the Directive 2006/43/EC from July 1st, 2009, highlights the fact that Article 41, on the establishment of audit committees, if the most frequently non-transposed article of the Directive[80].

Most Member States have only laid down the minimum requirements of the Directive into legislation, leaving more detailed recommendations to corporate governance codes. Some legislations however contain noteworthy features such as the election of the audit committee by the general meeting of shareholders (in Greece and Hungary, and in some instances in Slovakia), or the reporting of the audit committee directly to the general meeting (in Latvia).

Remuneration and nomination committees

Like audit committees, the basis for remuneration and nomination committees originate from corporate governance codes. Remuneration committees are intended to discuss executive remuneration in a more independent manner than the board as a whole would. Nomination committees are meant to propose candidates for director and corporate officer positions and to establish processes in that regard. These two committees may be combined, an option quite commonly chosen by listed companies, especially SMEs.

[75] Some codes have specific requirements regarding financial experts. The Bulgarian and Slovakian codes require financial experts to have at least five years experience in the field of finance and accounting; the Latvian code recommends that at least three members of the code have financial expertise.
[76] See Annex 1 of Commission Recommendation 2005/162/EC.
[77] Article 41 of Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, dated May 17th, 2006; available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:157:0087:0107 :EN:PDF.
[78] In Malta and the United Kingdom.
[79] In Estonia and Luxembourg, transposition of the Directive was in progress as of the drafting date of this report. Ireland, the 2003 Companies Act foresees the mandatory requirement to set an audit committee but this provision has not formally been implemented and remains unenforced. Note that Finland has transposed the directive without requiring the set-up of audit committees, as §5 of Article 41 of the Directive allows.
[80] Scoreboard of the European Commission on the transposition of the Statutory Audit Directive (2006/43/EC), dated July 1st, 2009; available at: http://ec.europa.eu/internal_market/auditing/docs/dir/01_07_09_scoreboard_en.pdf.

Despite fairly divergent code provisions concerning remuneration and nomination committees from one code to the other, both had long been left almost unaddressed by European institutions[81]. Remuneration committees were briefly mentioned in point 3.5 of Commission Recommendation 2004/913/EC, and the creation of remuneration and nomination committees along with audit committees was proposed in the 2005 Commission Recommendation, together with a number of suggestions on their composition, role and functioning[82]. But it's only recently that remuneration committees were more formally introduced in European legislation, in the 2009 Commission Recommendation on remuneration[83]. Points 7 to 9 of the 2009 Recommendation, however, still do not formally recommend their establishment, but instead discuss their composition (at least one remuneration specialist, but no recommendations concerning independence), role and functioning. So far, nomination committees have not been addressed independently by EU regulation.

At the level of the individual Member States, although some national laws allow the existence of remuneration and nomination committees, none require their establishment. Remuneration and nomination committees are therefore still deeply rooted in national corporate governance codes rather than national or European legislation. Similar to how codes treat audit committees, codes usually raise the recommended levels of non-executive and independent board members compared to the guidelines set for the board at large (if any).

3.2 Executive remuneration

In its Company Law Action Plan of May 2003, the EU Commission defined directors' remuneration as one of the main policy objectives that should promulgate future action to be taken at the EU level in the areas of corporate governance and company law. To address this issue, instead of formal harmonisation, the EU Commission has chosen to encourage the convergence of practices and regulations in the EU Member States by introducing non-binding recommendations. As a result, the European Commission adopted Recommendation 2004/913/EC on remuneration of directors of listed companies[84], which provides high standards of disclosure on directors' pay and recommends a greater shareholder involvement in the decisions relating to remuneration.

The Recommendation contains four main provisions:

- *Disclosure of company remuneration policies*: the Recommendation states that shareholders should be provided with a clear and comprehensive overview of company remuneration policies. The information should include, at least, the importance of the variable and non-variable components of directors' remuneration, the performance criteria on which any entitlement to share options, restricted shares or variable components of remuneration is based; the link between remuneration and performance; the main parameters and rationale for any annual bonus scheme and non-cash benefits; and the main characteristics of supplementary pensions or early retirement schemes.

- *Shareholders' vote on remuneration policy*: it is recommended that remuneration policy should be an explicit item on the agenda of annual general meetings under a separate voting item. Shareholders' vote at the meeting may either be binding or advisory.

- *Disclosure of individual directors' remuneration*: it is recommended that the total remuneration and other benefits granted to individual directors should be disclosed in detail in the annual accounts (or in the notes to the annual accounts) or in a remuneration report.

[81] Commission Recommendation 2004/913/EC on fostering an appropriate regime for the remuneration of directors of listed companies, dated December 14th, 2004; available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do? uri=OJ:L:2004:385:0055:0059:EN:PDF.
[82] See Annex 1 of Commission Recommendation 2005/162/EC.
[83] Commission Recommendation 2009/385/EC complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies, dated April 30th, 2009; available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:120:0028:0031:EN:PDF.
[84] See footnote 81.

- *Prior shareholder approval of share-based remuneration schemes*: it is recommended that share-based remuneration schemes be subject to the approval of shareholders by way of a separate resolution at the annual general meeting prior to their adoption.

Member States were invited to take the necessary measures to promote the application of the Commission Recommendation by June 30th, 2006, either through legislation or through best practice rules based on the comply-or-explain principle, and to notify the European Commission of the measures taken accordingly in order to enable the Commission to closely monitor the situation and assess the need for further measures.

In 2007 the Commission published a Report on the application of the Recommendation by 21 Member States[85]. The Report shows a divergence in the level of application of each provision as well as in the characteristics of their implementation. As a result, practices regarding the disclosure of executive remuneration vary significantly across the EU. The level of application of the Recommendations is reported to be relatively high with the exception of the provisions on shareholders' vote on remuneration policy.

The following analysis builds on the EU Commission's report in respect to the implementation of the Recommendation and complements it in two aspects. First, it covers a longer time frame and analyses data as of June 2009. Secondly, it takes into consideration the six Member States (Bulgaria, Cyprus, Czech Republic, Portugal, Romania, and Spain) which were not considered in the Commission's Report.

Regarding the *disclosure of remuneration*, the following may be observed:

- All but four Member States[86] require the *disclosure of remuneration policy*[87]. This should be considered an improvement in comparison to the situation documented in the Commission's Report where only 60% of the Member States followed the Commission's recommendation. This requirement is, in most cases, set by corporate governance codes in the respective Member States.

- The majority[88] of Member States require the disclosure of information on executive remuneration on an *individual basis*. In half of these Member States disclosure is required by law.

- A majority of Member States do require the disclosure of information on *share-incentive schemes*; however, the content of such disclosure differs significantly among Member States. Some require a highly detailed individual disclosure in terms of number of share options granted, exercised, and unexercised, as well as some other additional data[89]. In a number of Member States, this is usually imposed by law[90], while in others this is a code requirement. Finally, some Member States only require the disclosure of aggregate information instead of individual disclosure[91].

- Most Member States require the linking of variable remuneration to some identifiable *performance criteria*; however, only half of the 27 Member States require the disclosure of

[85] Commission Staff Working document, *Report on the application by Member States of the EU of the Commission Recommendation on directors' remuneration*, SEC (2007) 1022, dated July 13th, 2007; available at: http://ec.europa.eu/internal_market/company/docs/directors-remun/sec20071022_en.pdf.
[86] Estonia, Poland, Greece and Italy.
[87] In Bulgaria there is no explicit requirement to disclose the remuneration policy; however, the code requires that the amount and criteria for the remuneration of board members be approved by the general meeting. Moreover, the remuneration of board members must be disclosed in accordance with the law and the company's by-laws. Shareholders should have easy access to information concerning the remuneration of Directors. Therefore, we consider the requirement to disclose the remuneration policy satisfied.
[88] Belgium, Bulgaria, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Latvia, Lithuania, Malta, the Netherlands, Poland, Portugal, Slovenia, Slovakia, Spain, Sweden, and the United Kingdom. In Belgium, the requirement to disclose information on an individual basis, applies only to CEOs and non-executive directors.
[89] Such as Belgium, Ireland, Italy, France, Lithuania, Latvia, Slovakia, Sweden, the Netherlands, and the United Kingdom.
[90] Such as France and the United Kingdom.
[91] Such as Austria and Cyprus.

such performance criteria[92]. In this context, the United Kingdom stands out as a noteworthy example, as the British Listing Rules contain the requirement to publish the actual performance alongside the pre-set performance criteria.

- The disclosure of *other types of remuneration* (e.g. benefits, pension schemes, contracts, or severance payments) is handled quite differently from one Member State to the other. Many codes require the disclosure of these other types of remuneration on an aggregated basis, some require to disclose the principles according to which such remuneration is granted.

Regarding *shareholders' participation*, the following may be observed:

- 11 Member States[93] have established the requirement to seek shareholders' vote either on remuneration policy (ex ante)[94] or remuneration reports (ex post)[95]. Most of these Member States require a binding vote. Advisory vote is possible only in Lithuania, Spain, and the United Kingdom.

- In a majority of cases, the requirement to vote on remuneration stems from the code. This requirement may alternatively or additionally be laid down in the law[96].

- Moreover, in France and Ireland, shareholders indirectly vote on remuneration information as part of the vote on the annual report and annual accounts, but not in a separate item. This requirement is regulated by law in these Member States.

- In Germany, the recent *Act on the Appropriateness of Executive Remuneration*[97] approved on June 18th, 2009 lays down for the first time in German legislation the possibility for companies to seek shareholders' approval on their remuneration policy via an advisory vote[98].

- In some other Member States, although there is no requirement concerning shareholders' vote on remuneration, shareholders may be involved in the process of setting executive remuneration through other mechanisms[99]. This provides shareholders with the opportunity to express their views on remuneration issues.

The majority of Member States follow the Commission's Recommendation regarding the approval of share-based remuneration schemes by shareholders at the general meeting. This requirement is quite often implemented through law.

Recommendations 2004/913/EC and 2005/162/EC on executive remuneration and the role of non-executive directors and board committees were, in 2009, complemented by two new EU Recommendations, of which one is on the subject of directors' remuneration in listed companies[100].

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92 The corporate governance codes in Bulgaria, the Czech Republic, Finland, Greece, Poland, and Romania have neither the requirements to establish performance criteria nor the requirement to disclose such criteria.

93 Bulgaria, Cyprus, Hungary, Lithuania, Malta, the Netherlands, Romania, Slovakia, Spain, Sweden, and the United Kingdom.

94 Cyprus, the Netherlands, Sweden, Bulgaria, Hungary, Lithuania, Malta, Romania, and Slovakia.

95 Lithuania, Spain, and the United Kingdom.

96 In Bulgaria, the requirement is legal only. In Hungary, the Netherlands (ex-ante vote on remuneration policy), and the United Kingdom, the requirement is both in the code and in legislation. In Sweden, the requirement to vote ex-ante on remuneration policy has been removed from the 2008 code after its integration in the law, but discussions to suppress this requirement from the law and insert it back in the code were taking place in Sweden at the drafting date of this Study.

97 Gesetz zur Angemessenheit der Vorstandsvergütung (VorstAG), adopted on June 18th, 2009 and entered into force on August 5th, 2009; available in German at: http://www.bmj.bund.de/files/0696ec3400ab7abd918ee5dc9b817cdd/3836/gesetz_vorstandsverguetung_VorstAG.pdf.

98 A similar but code-based system of optional advisory vote on executive remuneration already exists in Switzerland since the 2007 revision of the Swiss corporate governance code. The system has however had limited impact before the 2009 campaign of Geneva-based foundation Ethos together with a number of pension funds, filing shareholder proposals at a number of major Swiss corporations to force them to submit their remuneration reports to an advisory shareholder vote.

99 For example, in the Czech Republic, the code provides that shareholders must be able to make their views known on board members and key executives' remuneration policy. In Estonia and Portugal it is recommended that companies' remuneration policy be presented at general meetings.

100 Commission Recommendation 2009/385/EC complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies, dated April 30th, 2009; available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:120:0028:0031:EN:PDF.

The recommendation is a non-binding instrument, recommending that Member States introduce measures to facilitate the convergence of national legislation on issues of common interest within the European Union. Member States are invited to implement measures in accordance with the recommendation by December 31st, 2009.

The 2009 Commission recommendation advises Member States to:

- set a limit of 2 years maximum of fixed component of director remuneration on severance pay and to ban severance pay in case of failure;
- require a balance between fixed and variable remuneration and link variable remuneration to predetermined and measurable performance criteria to strengthen the link between performance and pay;
- promote the long-term sustainability of companies through a balance between long- and short-term performance criteria for directors' remuneration, deferment of variable remuneration, a minimum vesting period for stock options and shares (at least three years), and retention of part of the shares until the end of the employment contract;
- allow companies to reclaim variable remuneration awarded on the basis of data which proved to be manifestly misstated ("clawback");
- extend certain disclosure requirements contained in the 2004 Recommendation to improve shareholder oversight of remuneration policies;
- provide that non-executives should not receive share options as part of their remuneration to avoid conflict of interests;
- strengthen the role and operation of the remuneration committee through new principles on (i) the composition of remuneration committees; (ii) the obligation for the members of the remuneration committee to be present at the general meeting where the remuneration policy is discussed in order to provide explanations to shareholders; and, (iii) avoiding conflicts of remuneration consultants;
- ensure that shareholders, in particular institutional investors, attend general meetings where appropriate and make considerate use of their votes regarding directors´ remuneration.

The Commission will closely monitor the application of the Recommendation and make its finding public through scoreboards. After one year, the Commission will examine the Recommendation in light of the experience acquired and of the outcome of the monitoring and will submit an evaluation report on Member States' application of both Recommendations.

The Recommendation’s provisions are not entirely new and have already been in place either in the legislation or the codes in a number of Member States. For example, the ban on share options grants for non-executive directors as part of their remuneration was already introduced in corporate governance codes in Belgium and the United Kingdom. The Recommendation’s different best practices are however not common practice in every Member State.

3.3 Internal control and risk management

Contrary to the situation in the United States, where internal control and risk management issues are heavily regulated both in law and in securities regulations[101], those issues have not, so far, been

[101] See Sarbanes-Oxley Act, dated July 30th, 2002; available at: http://uscode.house.gov/download/pls/15C98.txt. See also the Securities Exchange Commission Rules Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, dated June 2003; available at: http://www.sec.gov/rules/final /33-8238.htm.

a central focus of European policies. The European Commission touches upon this subject via its 2009 Recommendation on executive remuneration in the financial sector[102] and the current revision process of the capital requirements directive[103]. But for the most part, these issues are mainly dealt with by corporate governance codes, with the exception of two essential duties established by European legislation in relation to recommendations and in relation to requirements relating to audit committees and governance reporting:

- The duty for audit committees (or alternative bodies) to monitor the effectiveness of companies' internal control, internal audit (if any), and risk management systems[104];

- The duty for companies to include, in their corporate governance statement, a description of the main features of their internal control and risk management systems in relation to the financial reporting process[105].

As mentioned previously, Member States have, for the most part, transposed the provisions covering audit committees contained in Directive 2006/43/EC into their own national laws. Still, the observation that Article 41 of the Directive is the Directive's most frequently non-transposed article also has an important impact on the already weak positioning of internal control and risk management within the European framework[106]. Concerning the reporting obligation under Directive 2006/46/EC, the provision to publish a corporate governance statement including a description of internal control and risk management structures has been implemented by almost all Member States as mentioned in the introduction.

Although the majority of codes do not provide a definition of internal control and risk management systems[107], all national codes contain some provisions regarding these issues. However, there are many differences in the scope and content of regulation.

Codes vary considerably when determining the body responsible for ensuring the development of a reliable system of internal control. Some Member States assign such functions to the board of directors or supervisory board[108], others to the management board[109], and some Member States assign such functions to both[110]. In a few cases, this task may also be performed by the executive management[111].

Controlling activities frequently involve the set-up of an appropriate framework as well as periodic reviews and assessments of the framework's effectiveness. Some codes foresee the obligation to report on internal control and risk management issues to shareholders. In the Netherlands, the 2003 code required that the management board would also declare, in the annual report, that the internal risk management and control systems in place are adequate and effective. Instead, the new 2008 Dutch code provides that, with respect to financial risks reporting, the management board should state that the internal risk management and control systems provide a reasonable assurance that the financial reporting does not contain any errors of material importance and that the risk management and control systems worked properly in the year under review. At European level, the European Corporate Governance Forum has suggested in its Statement on Risk Management and

[102] Commission Recommendation 2009/384/EC on remuneration policies in the financial services sector, dated April 30th, 2009; available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:120:0022:0027:EN:PDF.
[103] See the press release from the European Commission, dated July 13th, 2009; available at: http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1120&format=HTML&aged=0&language=EN&guiLanguage=en.
[104] Article 41 of Directive 2006/43/EC.
[105] Article 7 of Directive 2006/46/EC.
[106] See Chapter I–3.1.4.
[107] We have identified definitions only in the Belgian code, which describes it as, "systems to identify, assess, manage and monitor financial or other risks," and in the Italian code, which defines internal control system as, "the set of rules, procedures and organizational structures aimed at making possible a sound and correct management of the company consistent with the established goals, through adequate identification, measurement, management and monitoring of the main risks." We have also identified that, in France and Finland, the definition for internal control is the one established by COSO (Committee of Sponsoring Organizations of the Treadway Commission). According to this definition, internal control is broadly defined as a process, carried out by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.
[108] For example in Cyprus, Denmark, Finland, Italy, and Lithuania.
[109] For example in Austria, Estonia, Germany, Hungary, and Latvia.
[110] For example in the Czech Republic and Malta.
[111] For example in Belgium and Slovenia.

Internal Control that, "while confirming that companies' boards are responsible for monitoring the effectiveness of internal control systems, there is no need to introduce a legal obligation for boards to certify the effectiveness of internal controls at EU level[112]."

Codes also specify that internal control should be carried out by some structured body within the company: internal audit function, department, or unit. In some cases, the recommendation to establish a separate unit is conditional on the size of the company and the complexity of its activities[113]. However, codes often recognize that the need to create such a unit should be reassessed regularly[114]. In this context, Greece presents an interesting example of mandatory and highly regulated creation of an internal control function within listed companies[115].

Codes also elaborate on the functioning and duties of the audit committee in monitoring internal control and risk management systems. This complements the mandatory rules set by EU legislation.

In some Member States, extensive guidelines regarding the implementation of internal control and risk management systems exist in addition to the code:

- In France, the securities regulator AMF issued two publications to define the internal control process, creating a reference framework setting general principles for a company's internal control processes. Two questionnaires are annexed to the reference framework: one on internal accounting and financial controls and the other on risk assessment and risk management. The latter, an *Application Guide for the internal control procedures relating to financial reporting,* outlines the principles and key points of analysis to be taken into account when setting up an internal control processes.

- For the United Kingdom and Ireland, the FRC issued the Turnbull Guidance[116] on the implementation of sound systems of internal control.

The parameters of internal control and risk management systems are hence based on the minimal requirements of two European Directives, which are further detailed in corporate governance codes or separate guidelines.

3.4 Statutory auditors

Statutory audit has a relatively long history of harmonisation on the European level. In 1978, Directive 78/660/EEC (4th Company Law Directive) introduced the requirement for companies to have their annual accounts audited by statutory auditors. Since then, the subsequent amendments to this Directive have harmonised the provisions on auditors, accounting standards and content of reports across the Union[117].

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[112] Statement of the European Corporate Governance Forum on Risk Management and Internal Control, June 2006, available at http://ec.europa.eu/internal_market/company/docs/ecgforum/statement_internal_control_en.pdf.
[113] For example in Austria.
[114] For example in Cyprus, the Czech Republic, Denmark, and Sweden.
[115] In Greece, the organisation and operation of internal control is a prerequisite for the listing on an organised exchange. The internal control is performed by an ad hoc department of the company. Internal controllers are independent in performing their duties, do not report to any other corporate department and are supervised by one to three non-executive members of the Board of Directors. They are appointed by the Board of Directors and are full-time employed.
During the conduct of their duties, the internal controllers are entitled to access to any book, document, archive, bank account, and portfolio of the company, as well as to have access to any department of the company. The Board members are obliged to cooperate with the internal controllers, provide information to them, and facilitate the performance of their duties under any way. The management of the company is subject to the obligation to provide the internal controllers with all means for the facilitation of their duties.
[116] Financial Reporting Council, Revised Guidance for Directors on the Combined Code, dated October 2005; available at: http://www.frc.org.uk/documents/pagemanager/frc/Revised%20Turnbull%20Guidance%20October%202005.pdf.
[117] Eighth Council Directive 84/253/EEC dated April 10th, 1984, based on Article 54 (3) (g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents; Directive 2003/51/EC of the European Parliament and of the Council dated June 18th, 2003, amending Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC on the annual and consolidated accounts of certain types of companies, banks and other financial institutions and insurance undertakings; Directive 2008/30/EC of the European Parliament and of the Council dated March 11th, 2008, amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts, as regards the implementing powers conferred on the Commission; Recommendation 2008/473/EC dated June 5th, 2008, concerning the limitation of the civil liability of statutory auditors and audit firms; Recommendation 2008/362/EC dated May 6th, 2008 on

In 2006, Directive 2006/43/EC[118] introduced a wide set of brand new minimum requirements relating to the regulation of statutory auditors' activities. The Directive establishes the following main requirements[119]:

- The auditor shall be appointed by the general meeting of shareholders upon recommendation of the audit committee.
- The auditor shall report to the audit committee on key matters.
- Auditors shall: (a) annually confirm their independence; (b) annually disclose any additional services provided; and, (c) discuss with the audit committee any threat to their independence and the safeguards applied to mitigate those threats.
- The key audit partner(s) shall rotate at least every seven years. They can be permitted to perform audit for the same company again after a period of at least two years.
- Auditors may only be dismissed for justified reasons. Divergence of opinion on accounting treatments or audit procedures shall not be proper grounds for dismissal.
- Auditors shall inform the authority responsible for public oversight on their dismissal or resignation before their term of appointment and give an adequate justification.
- The auditors of the consolidated accounts of a group of companies audited by several different firms in a large number of locations worldwide shall take full responsibility for the audit of those consolidated accounts. In doing this, the group auditor is obliged to review and document the work of other auditors.

As of July 1st, 2009, 22 Member States had informed the European Commission about their full transposition the Directive, while five Member States[120] provided information about partial or non-transposition[121].

National transposition measures concerning statutory auditors are pretty uniform across Member States, as the auditors' activity is mainly regulated by laws and other regulatory instruments. Codes in a number of Member States also contain provisions on statutory audit; however, these provisions often reiterate or detail legal provisions. The most frequent provisions of corporate governance codes regarding auditors deal with the modalities of auditors' appointment[122], disclosure of non-audit services provided and pertaining fees[123], auditors' independence requirement and criteria[124], or rotation periods[125].

In Member States where the Directive was still not fully transposed at the drafting date of this Study, the activities of statutory auditors are regulated both by law and by codes. In this case laws

external quality assurance for statutory auditors and audit firms auditing public interest entities; Decision 2008/627/EC dated July 29th, 2008, concerning a transitional period for audit activities of certain third country auditors and audit entities.

[118] Directive 2006/43/EC on statutory audit of annual accounts and consolidated accounts and amending Council Directives 78/660/EEC and 83/349/EEC.

[119] Some of these requirements only apply to statutory auditors of public interest entities.

[120] Austria, Estonia, Italy, Ireland, and Luxembourg.

[121] See footnote 80.

[122] For example in the Netherlands the code provides that "The external auditor is appointed by the general meeting of shareholders. The supervisory board shall nominate a candidate for this appointment, for which purpose both the audit committee and the management board advise the supervisory board."

[123] For example in Hungary the code provides that "[2.9.2.] In the event that the company, or its management give an assignment to the company's auditor to provide other professional services, the Managing Body, the Supervisory Board and the Audit Committee should be notified in all cases when the fee for the services, the type of the service or any other circumstance may result in significant additional expenses for the shareholders or may cause a conflict of interest, or affect normal business practices significantly in any other way."

[124] For example, in Slovakia the code provides that, "The independence of auditors is also ensured by banning auditors and persons dependant on them from having a financial share or a managing position in companies which they audit. It is regarded as good practice if such a ban extends also to the lower-level employees of auditing companies."

[125] For example in Slovenia the code provides that "The company should change the auditing firm or auditor-partner at least every five years."

are also the predominant regulatory measure. In several instances code provisions are more demanding than legal requirements, and are in line with the Directive principles[126]. However, code recommendations in those Member States do not fully implement the Directive requirements and cannot replace the mandatory transposition.

Directive 2006/46/EC also imposes the requirement that statutory auditors assure that the corporate governance statement has been produced. This issue will be discussed in greater detail hereafter[127].

[126]For example, in Spain the code provides that, "The company should notify any change of auditor to the CNMV as a significant event, accompanied by a statement of any disagreements arising with the outgoing auditor and the reasons for the same" and that "In the case of groups, the Committee should urge the group auditor to take on the auditing of all component companies."

[127] See Chapter I–3.4.

4 RELATIONSHIP BETWEEN LEGISLATION AND CODES: RULES APPLYING TO SHAREHOLDERS

4.1 Shareholder rights

The sphere of shareholder rights has been dominated for some time by national rules: a number of Member States have granted fundamental rights to shareholders, either via legislation or through corporate governance codes. With Directive 2007/36/EC[128], the European Union laid down a number of rights Member States have to guarantee to local and foreign shareholders. Those rights include among others:

- the equal treatment of shareholders regarding the participation to shareholder meetings and the exercise of voting rights thereat;
- the right to information (including a general meeting notice);
- the right to ask questions at a general meeting and introduce shareholder proposals;
- the right to different options to cast a vote (*in personae*, via proxy voting, by electronic means, by correspondence).

As the deadline to transpose the directive had not yet elapsed by the drafting date of this Study[129], limited information was available on how Member States had implemented the Directive's provisions. As of that date, and although a number of Member States already guarantee the fundamental shareholder rights contained in the Directive, only Poland had reported on transposition measures[130].

Additionally, one Member State has incorporated in its corporate governance code the shareholder right to discuss any substantial change in the corporate governance structure of companies as a separate agenda item[131].

4.2 Shareholder responsibilities

The field of shareholder responsibilities is much less harmonised at European level than that of shareholder rights. The 2002 Report of the High Level Group of Company Law Experts[132] noted at the time that shareholders, especially institutional investors, were "ideally placed to act as a watchdog" of good governance and that their traditional action tool was voting at general meetings. Hence, although the Group's consultation showed mixed responses concerning a possible formalisation of the institutional investors' role, the report recommended some form of regulation at Member State level in order to oblige shareholders to disclose their voting policies and voting records. According to Recommendation III.7 of the Report, "regulation of the relevant types of institutional investors by Member States should include an obligation on those institutional investors to disclose their investment policy and their policy with respect to the exercise of voting rights in

[128] Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies, dated July 11th, 2007; available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:184:0017:0024:EN:PDF.

[129] Transposition deadline was set on August 3rd, 2009. Further information gathered after the drafting date of this Study show that only Bulgaria and Poland notified transposition by the transposition deadline, while Germany and the United Kingdom had adopted measures without formally notifying the European Commission. As of September 10th, 2009, RiskMetricsGroup identified 11 Member States having adopted the necessary changes: Austria, Bulgaria, Denmark, Finland, Germany, Ireland, Lithuania, Poland, Romania, Slovenia, and the United Kingdom. Additionally, EEA Member State Norway also transposed the Directive.

[130] For updated information on the state of transposition of the Directive, refer to: http://eur-lex.europa.eu/Notice.do?val=488112:cs&lang=en&list=488112:cs,&pos=1&page=1&nbl=1&pgs=10&hwords=&checktexte=checkbox&visu=#FIELD_FR.

[131] See the corporate governance code in the Netherlands, recommendation I.2: "Each substantial change in the corporate governance structure of the company and in the compliance of the company with the code shall be submitted to the general meeting of shareholders for discussion under a separate agenda item".

[132] Final Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, dated November 4th, 2002; available at: http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf.

companies in which they invest, and to disclose to their beneficial holders at their request how these rights have been used in a particular case."

As a response to the experts' report, the European Commission endorsed these recommendations in its 2003 Action plan, foreseeing two clear obligations for institutional investors:

- the disclosure of their investment policy and their policy with respect to the exercise of voting rights in companies in which they invest;
- the disclosure to their beneficial holders at their request of how these rights have been used in a particular case.

A strict requirement for institutional investors to systematically exercise their voting rights was ruled out by the Commission. However, according to the Commission's Action plan, the disclosure requirements would, "not only improve the internal governance of institutional investors themselves, but would also enhance participation by institutional investors in the affairs of the companies in which they invest[133]."

Despite its intention to "take the necessary steps in the medium term" stated in the 2003 Action plan, the EU has not yet given the same attention to the matter as it has for shareholder rights. Indeed, after launching a public consultation on the objectives of the Action Plan, and despite significant public support for investment policies disclosure by investors, the European Commission noted limited support for European action on this subject[134]. It therefore decided to leave the topic of shareholder responsibilities entirely to national initiatives. When institutional investors decide to exercise the rights attached to the securities contained in their portfolio, they, as mandate holders for their beneficial owners, have an inherent obligation of due care and diligence, according to the law of any European Member State.

In addition to the general duty of care, a few Member States have implemented complementary duties for institutional investors in order to generate a more active form of participation. So far, four Member States[135], France, the Netherlands, Portugal, and, to a lesser extent, the United Kingdom, have implemented specific rules in that regard, using noticeably different methods.

4.2.1 Disclosure obligations in Portugal, the Netherlands and France

In ***Portugal***, the first Member State to implement disclosure duties for institutional investors in 2003, a mix of legislation and securities regulation require institutional investors to:

- present their voting policy in the UCITS' management rules, keep this information available to the UCITS' beneficial owners, and inform the securities regulator of the policy[136]; any change to the policy has to be publicly available and communicated to the regulator;
- report on the exercise of voting rights in accordance with the policy[137] via an annual report available to the securities regulator;
- provide an explanation whenever votes are cast which diverge from the UCITS' voting policy[138].

The Portuguese securities regulator provides investors with a standard template to report voting records[139].

[133] See footnote 49.
[134] See http://ec.europa.eu/internal_market/company/docs/consultation/final_report_en.pdf and http://ec.europa.eu/internal_market/company/docs/modern/governance-consult-responses_en.pdf for more information on the subject.
[135] Note that Slovakian law also contains obligations for institutional shareholders, but they are, so far, limited to the disclosure of the voting policy in the fund's bylaws.
[136] Article 65 of the Decree-Law 252/2003, dated October 17th, 2003; available at: http://www.cmvm.pt/NR/exeres/54C4A4AB-1CCE-46CB-A874-D355AB62D88C.htm?WBCMODE=Pr.
[137] Article 74 of the Decree-Law 252/2003.
[138] Article 81 of CMVM Regulation 15/2003.

Figure I-4-1: **Example of voting disclosure form for investors (Portugal)**

Appendix 11
Table giving notice of exercise of Voting Rights

(Information specified in Article 81 of the Regulations governing Collective Investment Undertakings)

Management entity: ***Identification of management entity.***
Form of exercise: ***Identification of the manner in which the voting right was exercised, identifying, as the case may be, the representative of the management entity and its relation with the management entity, and also the terms of the mandate given.***
Issuing entity: ***Identification of the respective issuing entity and of the shares which are the subject of representation (ISIN code and name).***

CIUs	Number of shares held	% of voting rights	Decisions made by General Meeting	Vote given for or against	Justification of vote given
(1)	(2)	(3)	(4)	(5)	(6)

(1) Identification of the CIUs which held shares in the issuer on the date of the General Meeting of Stockholders.
(2) Number of shares held by each CIU and by the total of the CIUs on this same date.
(3) Percentage of the voting rights held by each CIU and by the total of the CIUs.
(4) Identification of the decisions of the General Meeting of Stockholders of the issuer.
(5) Vote given for or against.
(6) Justification of why the vote was given for or against the proposal, in relation to each of the decisions.

Source: CMVM Regulation 15/2003 (Portugal)

In ***the Netherlands***, a combination of legislation and corporate governance code provisions are used. Originally, Principle IV.2 of the 2003 Dutch corporate governance code recommended institutional investors report on the exercise of voting rights. Principle IV.4 of the code, pushing for "dialogue" between investors and companies, elaborates on this recommendation of Principle IV.2 and suggests that:

- institutional investors (pension funds, insurers, investment institutions and asset managers) shall publish annually, on their website, their policy on the exercise of the voting rights for shares they hold in listed companies;
- institutional investors shall report annually, on their website and/or in their annual report, on how they have implemented their policy on the exercise of the voting rights in the year under review;
- institutional investors shall report at least once a quarter, on their website, on whether or not, and, if so, how, they have voted as shareholders at general meetings.

This set of recommendations has been reinforced by Article 5:86 of the 2006 Financial Supervision Act[140], which mandates the public reporting recommended by the code.

[139] Article 81 and 82 of CMVM Regulation 15/2003 on Collective Investment Undertakings and Appendix 11, dated December 2003, available at: http://www.cmvm.pt/NR/exeres/167C9298-D659-4BCD-AD41-E538EB9EB5C4.htm ?WBCMODE=Pr.
[140] Financial Supervision Act, dated September 26th, 2006; available at: http://www.afm.nl/corporate/upl_documents/act_on_financial_supervision_050107.pdf, last visited June 10th, 2009.

In ***France***, a mix of legislation and securities regulation comparable to the Portuguese system requires institutional investors to:

- present their voting policy in a specific statement, keep this information available to the UCITS' beneficial owners, and inform the securities regulator of the policy[141]; any change to the policy has to be publicly published and communicated to the regulator;
- report on the exercise of voting rights according to the policy, via an annual report to the securities regulator[142];
- provide an explanation whenever votes are cast in divergence from the UCITS' voting policy[143], and whenever voting rights are not exercised[144].

These three structures rely on a comply-or-explain system, this time directed towards investors. Investors set up their own voting policy. Once this voting policy is set, the system works in a similar fashion to the comply-or-explain regime directed towards companies: whenever a vote is not cast, or cast divergently from the self-imposed policy, the investor has to explain the reason for doing so.

4.2.2 Disclosure recommendations in the United Kingdom

In ***the United Kingdom***, a similar, but strictly voluntary system[145], recommends that institutional investors:

- take steps to ensure that their voting intentions are being translated into practice;
- make available to clients, at their request, information on the proportion of resolutions for which votes were cast, and non-discretionary proxies lodged;
- attend AGMs where appropriate and practicable, if they are the major shareholder. Companies and registrars should facilitate this.

These principles, contained in Section 2 of the Combined code (Principle E.3), have, according to the British Institutional Shareholders' Committee, not proved efficient in pushing investors to vote at general meetings and report thereon[146]. Some professional associations are advocating for a more effective exercise of their voting rights by institutional investors[147].

The recent *Walker Review* to the Combined Code, published on July 16th, 2009, suggests in a series of recommendations to detach the provisions of Section 2 of the Combined Code targeting investors into separate "Principles of Stewardship" of communication and engagement. It further recommends that institutional investors commit to follow these principles and report accordingly. Where investors would not be ready to commit to the principles and report on them, "it should provide, similarly on the website, a clear explanation of the reasons for the position it is taking"[148]. The Walker Review hence proposes a comply-or-explain-based system of reporting for engagement and voting, on the basis of a uniform standard established by the FRC, and promoted and monitored

[141] Article 314-100 of the General Regulation of the AMF (Autorité des Marchés Financiers – French securities regulator), available at: http://www.amf-france.org/documents/general/7553_1.pdf.
[142] Article 314-101 of the General Regulation of the AMF.
[143] Article 314-101 of the General Regulation of the AMF.
[144] Article L.533-22 of the French Monetary and Financial Code, available at http://www.legifrance.gouv.fr/affichCodeArticle.do?idArticle=LEGIARTI000006657987&cidTexte=LEGITEXT000006072026&dateTexte=20090617&oldAction=rechodeArticle.
[145] A mandatory disclosure requirement was introduced in the UK Companies Act although it has so far not yet been brought to force by the government.
[146] For more information on the matter, refer to: http://institutionalshareholderscommittee.org.uk/sitebuildercontent/sitebuilderfiles/ISCframeworkvotingdisclosureJun07.pdf.
[147] Especially two members of the above-mentioned Institutional Shareholders' Committee, namely the Association of British Insurers (ABI) and the National Association of Pension Funds (NAPF).
[148] Recommendations 16 to 21 of the Review of corporate governance in UK banks and other financial industry entities, dated July 16th, 2009; available at: http://www.hm-treasury.gov.uk/d/walker_review_consultation_160709.pdf.

by the FSA. To that extent, the *Walker Review* goes even further than the French, Dutch or Portuguese examples by providing a norm by which to report on a comply-or-explain basis.

4.2.3 Disclosure recommendations by institutional investor associations

A number of institutional investor associations support the idea of institutional investors disclosing their engagement strategy, as well as their voting policies and voting records. However, they tend to formulate their statements in diverging manners.

Some examples of best practices recommended by international as well as national institutional investor associations are presented hereafter:

The International Corporate Governance Network (ICGN)

In its 2007 Principles on Institutional Shareholder Responsibilities[149], the ICGN recognises that, "a relationship of trust is more likely to be achieved when institutional shareholders and their agents can demonstrate that they are exercising the rights of ownership responsibly." Such responsible action, beyond the application of consistent policies, and the use of successful engagement strategies, includes the exercise of voting rights by institutional shareholders. According to these principles, investors should:

- develop and publish a voting policy so that beneficiaries and companies understand what criteria are used to reach decisions;
- exercise voting rights in a way that reflects the specific circumstances of the case; where this involves a deviation from the normal policy, institutions should be prepared to explain the reasons to their beneficiaries and to the companies concerned;
- establish appropriate arrangements for reporting to beneficiaries on the implementation of voting policy, and on any relevant engagement with companies concerned; as a matter of best practice, institutional investors should disclose an annual summary of their voting records together with their full voting records in important cases. Voting records should include an indication of whether the votes were cast for or against the recommendations of company management.

The ICGN also notes in its principles that, "consideration should be given to the merit of voluntary public disclosure of an asset manager's voting record as this may be a way of demonstrating a commitment to accountability and to show that conflicts of interest are being properly managed."

The European Fund and Asset Management Association (EFAMA)

The EFAMA sets out in its Recommendations for Best Practices on Corporate Governance[150] that fund managers, acting as fiduciaries for their clients, should act in the sole interest of the latter. In order to pursue this objective, fund managers should, "act responsibly as shareholders among others by making considered use of their voting rights in line with this Statement of Principles and by maintaining an on-going dialogue as far as practicable with the companies in which they invest." EFAMA hence supports the publication of a specific voting policy, as well as an annual document describing the implementation of this policy in practice. In a statement commenting on the 2003 revision of the OECD principles of corporate governance[151], however, EFAMA states that it does not support initiatives compelling investment funds to disclose to beneficial owners at their request how voting rights have been used in specific cases.

[149] ICGN, *Principles on Institutional Shareholder Responsibilities*, dated 2007, available at: http://www.icgn.org/files/icgn_main/pdfs/best_practice/inst_share_responsibilities/2007_principles_on_institutional_shareholder_responsibilities.pdf.
[150] EFAMA, *Recommendations for Best Practices on Corporate Governance*, dated February 2nd, 2002; available at: http://www.efama.org/index.php?option=com_docman&task=doc_download&gid=181.
[151] EFAMA, *Comments on the OECD Principles of Corporate Governance - Draft revised text*, dated February 10th, 2004; available at: http://www.efama.org/index2.php?option=com_docman&task=doc_view&gid=248&Itemid=35.

National investors and asset managers associations

A number of national investors and asset managers associations also advise their members to disclose voting policies and voting records, including:

- The German Bundesverband Investment und Asset Management (BVI) recommends in its Good Behaviour Rules[152] that in application of their fiduciary duty, investors and asset managers have to inform their beneficial owners of the principles underlying their voting policy, and must exercise their voting rights effectively. BVI has however not published a recommendation regarding the disclosure of voting records.

- The Polish Chamber of Fund and Asset Management (IZFiA), in its Code of Good Practices[153], recommends that institutional investors develop and make public, “their own principles of voting during general meetings of public companies,” and lists a number of particular items for which such a policy should be established (share option grants, bylaw modifications, minority shareholder right changes, and anti-takeover defences). The document also states that institutional investors should, “regard as a principle the practice of disclosing their voting method [i.e. exercise of voting rights] to their clients and mass-media.”

- The Swedish Fondbolagens Förening (FBF) applies part of the guidelines set by the EFAMA in its Code of conduct for fund management companies[154], “...fund management companies must, in their shareholder policy, detail the principles that govern the exercise by the fund management company of its voting rights.” No principle on disclosure of voting records is laid down in the document.

[152] BVI, *Wohlverhaltensregeln*; available in German at: http://www.bvi.de/de/bvi/branchenstandards/wohlverhaltensregeln/wvr_pdf/wvr_01032006.pdf.
[153] IZFiA, *Code of Good Practices of Institutional Investors*, dated October 24th, 2006; available at: http://www.izfa.pl/files_user/pdf/CODE_OF_GOOD_PRACTICES_OF_INSTITUTIONAL%20INVESTORS.pdf.
[154] Fondbolagens Förening, *Code of conduct for asset management companies*, dated June 2008; available at: http://www.fondbolagen.se/upload/code_of_conduct_final_june_2008.pdf.

Summary of findings of Parts Two and Three

The following comparative table summarises the main findings of the first two sections of this chapter as regards the relation between legislation and corporate governance codes:

Figure I-4-2: **Relation between EU legislation, national legislation and codes**[155]

Corporate governance topic	EU level	National level	
		Legislation	Code
Composition and functioning of boards	Recommendation 2005/162/EC	***	**
Independence of board members	Recommendation 2005/162/EC	*	***
Audit committees	Directive 2006/43/EC	***	***
Remuneration and nomination committees	Recommendation 2004/913/EC Recommendation 2009/385/EC		***
Executive remuneration	Recommendation 2004/913/EC Recommendation 2009/385/EC	**	**
Internal control and risk management	Directive 2006/43/EC Directive 2006/46/EC	*	*
Statutory audit	Directive 84/253/EEC Directive 2003/51/EC Directive 2006/43/EC Directive 2006/46/EC Directive 2008/30/EC Recommendation 2008/473/EC Recommendation 2008/362/EC Decision 2008/627/EC	***	*
Shareholder rights		***	*
Procedural shareholder rights	Directive 2007/36/EC	**	*
Shareholder responsibilities		*	*

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

[155] Assessment made by RiskMetrics.

5 UPDATES TO CORPORATE GOVERNANCE CODES

In the view of a number of actors of the corporate governance arena, one of the key advantages of corporate governance codes is their flexibility. This plasticity is seen in the uncomplicated procedures used to keep codes up to date with economic and social realities and business practices. This helps keep them in line with international and national legislation, and developments in corporate governance. In order to maintain the living aspect of these instruments, codes and their provisions have to be reviewed regularly, and amended if required.

The outcome of such reviews is not necessarily an update of the code. Alternatively, the review of code provisions might provide an impetus for legislative action in certain fields. This usually happens when the application of the code proves insufficient and legislation with the attached public enforcement system is perceived as more efficient. On the other hand, legal changes themselves bring about changes in codes because codes function only within the boundaries of their own legal framework. A code that contradicts company law cannot be applied and needs to be modified. Therefore, in order to assess the effectiveness of corporate governance regulation in a particular legal system, code developments need to be put into the context of those of the underlying legal system. In other words, it is essential to determine how national legislators react to the results achieved through the monitoring mechanisms put in place.

In a majority of the 27 Member States, update systems for corporate governance codes are not been legal construct, but remain informal. Typically, studies on governance or corporate governance codes are not organised through a defined process or concrete rules. Nevertheless, informal and unofficial relations exist between interested parties, national legislators, and influential professional organisations that contribute to developments. Despite the lack of formal arrangements, past experience has proved that updates to codes regularly take place in almost all Member States.

Of the 27 Member States, six[156] have designed varying degrees of formal procedures to update their codes. In this context, a formal system of monitoring explicitly authorises one particular institution to perform the monitoring, and establishes the procedures and/or frequency of such monitoring. Nevertheless, even those six systems remain quite informal. The table below summarises the details of different European systems providing updates of corporate governance codes.

Figure I-5-1: **Update of corporate governance codes in the Member States**

Update of corporate governance codes in the Member States				
Member State	**Author of reference code**	**First initiative**	**First reference code**	**Nr of updates of the reference code**
AT	Austrian Working Group for Corporate Governance *(Professional associations & interest groups)*		2002	4
BE	Corporate Governance Committee *(Mixed public-private initiative)*	1998	2004	1
BG	Stock Exchange / National Corporate Governance Commission as of September 2009 (*Mixed public-private initiative*)	Jan-07	Oct-07	
CZ	Czech National Bank *(Public initiative)*		2001	1
CY	Stock Exchange		2002	3
DK	Nørby-udvalget *(Public initiative)*		2001	2
EE	Financial Supervision Authority *(Public initiative)*		2005	No
FI	Securities Market Association (*Professional associations & interests groups)*		1997	2
FR	AFEP - MEDEF- *(Professional associations)*	1995	2003	4

[156] See Chapter I-5.1.

Member State	Author of reference code	First initiative	First reference code	Nr of updates
DE	Government Commission on the German Corporate Governance Code *(Public/private initiative)*		2002	6
HU	Stock Exchange		2004	1
IE	UK Financial Reporting Council (*Professional association*[157])		2003	3
IT	Stock Exchange	1999	2006	2
LV	Stock Exchange		2005	1
LT	Stock Exchange		2004	1
LU	Stock Exchange		2007	No
MT	Malta Financial Supervisory Authority *(Public initiative)*		2001	2
NL	Specialized Monitoring Committee (*Mixed private initiative)*	1997	2003	1
PL	Stock Exchange		2002	1
PT	CMVM *(public initiative)*	1999	2007	4
RO	Stock Exchange		2001	1
SK	Stock Exchange		2003	1
SI	Stock Exchange		2004	2
ES	CNMV *(Public initiative)*	1998	2006	2
SE	Corporate Governance Board *(Mixed private initiative)*		2005	1
UK	UK Financial Reporting Council (*Professional association*[158])	1992	2003	3

5.1 Member States with formal revision systems

In Austria, Bulgaria, Germany, the Netherlands, Romania and the United Kingdom, the systems for code updates have some noteworthy features:

- In ***Austria***, the code must be reviewed once a year, taking relevant national and international developments into consideration, and should be adapted if required. The body responsible for code updates is the Austrian Working Group for Corporate Governance, which consists of representatives of listed companies, investors, and other market participants, supported by the Office of the Special Government Representative for the Capital Market. The requirement to update the code has been implemented in practice and the code has consequently been updated four times since its inception in 2002.

- In ***Bulgaria***, the review is performed by a task force consisting of representatives from the Bulgarian business community, the Bulgarian Stock Exchange, government and civil society organisations, and academics. As of September 3rd, 2009, the newly born Bulgarian Commission for Corporate Governance will be charged, among others, with the task to monitor the application of and propose amendments to the Bulgarian corporate governance code[159].

- In ***Romania***, the duty to update the code in accordance with the relevant legislation is vested in the Bucharest Stock Exchange. However, due to the fact that both ***Romania*** and ***Bulgaria*** introduced their codes only very recently, there are no examples of practical application of the mentioned provisions, hence impeding the evaluation of their effectiveness.

[157] 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.
[158] See footnote 157.
[159] The Bulgarian Commission for Corporate Governance is a public-private initiative launched by the Sofia stock exchange and the Bulgarian Financial Supervision Commission with the objective to develop and disseminate best practices, monitor the implementation of the Bulgarian corporate governance code by companies, and provide regulators with recommendations for improvements of the corporate governance legal and regulatory framework.

- In ***Germany***, the body responsible for the update of the code is the Government Commission on the German corporate governance code. The Commission is made up of 12 prominent representatives from companies, trade unions, associations, and law faculties, appointed by the federal Minister for Justice. As of 2009, the code had already been amended six times by the Commission since its original publication in 2002. Nevertheless, the amendments were only related to individual recommendations so that the code has remained relatively unchanged since 2002.

- In ***the Netherlands***, there is no predetermined frequency for the revision procedures; however, the Monitoring Committee, established by ministerial decree, was given the objective of promoting the use of the 2003 code and monitoring compliance with and application of the code. In its tasks of monitoring the provisions of the code, the Monitoring Committee keeps national and international developments in the field of corporate governance under review, and indicates any gap or ambiguity with the 2003 code.

  The Monitoring Committee reports to the Minister of Finance, the Minister of Justice and the State Secretary of Economic Affairs at least once a year. Its report includes comments and recommendations with regard to: (i) the compliance by companies and (ii) the adequacy of the 2003 code in the context of national and international standards and practices. However, the Monitoring Committee does not have any legislative power nor a mandate to amend the code. Therefore, its comments and recommendations do not automatically become part of the code, but may be used as an informal guideline for companies and shareholders. The code can only be amended upon ministerial order. The current edition of the code developed as a result of the said procedure. In other cases, recommendations of the Monitoring Committee have led to (planned) amendments in existing legislation or proposed new legislation[160].

  Initially an *ad hoc* committee (not being the Monitoring Committee) to evaluate the code in due time was supposed to be established. If necessary, this *ad hoc* committee could propose amendments, taking into account the annual comments of the Monitoring Committee, as well as social and international developments since the implementation of the code. However, such an *ad hoc* committee has not been created. Instead, the evaluation report was produced by the Monitoring Committee itself in 2008, which contained an evaluation of three years of monitoring and proposed amendments to the code.

- In ***the United Kingdom***, the code does not stipulate the frequency of updates but sets the exact date of the forthcoming update. The latest review of the British code was performed in 2007, and the current code foresees that the following update "in the normal course of events will take place in 2010." The Financial Reporting Council (FRC) started a public consultation for the 2010 update of the code on March 18th, 2009. In the past, there have been two major reviews, driven by formal consultations, reviews of annual reports disclosure by listed companies, and interviews held with chairmen of listed companies.

  The FRC performs its review through dialogue with preparers of accounts, board members, lawyers, actuaries, and accountants as well as investors. The FRC also monitors disclosure in annual accounts. Any change to the code is preceded by a due process, involving prior consultation on needs for change and recommendations, and resulting changes are brought in with sufficient lead time to enable companies to make appropriate arrangements. The FRC has the ability to issue amended versions of the code or further guidance in implementing the code where deemed necessary.

[160] For example, in its Advisory report on the company-shareholder relationship and on the scope of the Code as of May 2007 the Monitoring Committee recommended that the government to reduce the 5 percent threshold for disclosure of interests to 3 percent and impose a duty to report every change of 1 percent. The intention was to bring the disclosure requirements into line with international practice. The report is available at: http://www.commissiecorporategovernance.nl/page/downloads/Monitoring_Committee_Advisory_Report_May_2007.pdf.

5.2 Member States without formal revision systems

In the majority of Member States, however, no formalised system exists to identify shortcomings of codes and to propose updates. This does not mean that revision systems are non-existent. Informal *ad hoc* arrangements have been established and, in many instances, have proved to be efficient revision mechanisms.

In some Member States the duty to monitor code provisions arises from a general statement in the code itself. For instance, in ***Belgium*** the code states that it, "should lend itself to revision in the future in order to take account of the experience gained and the changes in legal and business practices. Therefore, the Committee will endeavour to have proper follow-up in place." Similar provisions are also contained in the ***Finnish, Lithuanian, Luxembourg, Portuguese, Slovenian, Italian, Latvian, and Swedish*** codes.

In other Member States the informal revisions take place on an *ad hoc* basis, even if there is no explicit review and update duty stipulated in the code. No significant difference in monitoring practices is observed regardless of whether the code contains an update provision or not.

The duty to review code provisions is usually imposed on the authors of the codes, i.e. most often stock exchanges or professional organisations. They review code provisions based on the relevant national and international developments in the area of corporate governance, as well as the practical application of codes by companies. The information gathered during such reviews serves as a basis for potential update or amendments recommendations. These bodies usually have the authority to amend or update the codes. For example, in ***Sweden***, the Corporate Governance Board is responsible for the management and administration of the code. It analyses how the code is applied in practice and monitors the development of corporate governance in Sweden and internationally. The Board can also make changes to the code when these are deemed necessary and appropriate. The Corporate Governance Board carries out surveys and analysis of different kinds. The results of these surveys constitute the foundation of the Corporate Governance Board's consideration when developing the code and improving its functionality.

In some other Member States the monitoring of code provisions is performed by financial market authorities:

- In ***Estonia***, the code can be amended or updated by the Financial Supervision Authority, which monitors the code while undertaking reviews and analysis of companies' practice. Although there have been no update to the Estonian code since its inception in 2005, a review concluded that some of the matters previously incorporated into the code should be regulated by law.

- In ***Malta***, the updates of the code are initiated by the Maltese Financial Supervision Authority. Since its introduction in 2001, the code has been updated several times, mostly to bring it in line with EU legislation.

- In ***Portugal***, without a formal legal basis, the securities regulator CMVM in practice updates and amends code recommendations every two years taking new legislation and market needs into consideration. It bases its analysis on the results obtained through the monitoring of companies' reports, engagement with companies, and execution of surveys and questionnaires.

- In ***Spain***, the code has been updated twice on an *ad hoc* basis at the initiative of the Spanish government, even though no formal procedure exists. Nevertheless, the securities regulator CNMV is officially in charge of the monitoring proceedings related to corporate governance duties of listed companies. Within its mandate, CNMV collects information on companies' practices and publishes, annually, two extensive reports regarding the corporate governance of listed companies[161]. This provides CNMV with comprehensive information about the actual state of the Spanish framework.

[161] See Chapter I-6.3.1

5.3 Alternative revision practices

Revision practices in the ***Czech Republic*** and ***Greece*** have unique features. In the ***Czech Republic*** the code is explicitly based on the OECD principles[162]. Therefore, the revision procedure is directly linked to changes in the underlying OECD document. The current code is an amended version, which reflects the amendments of the OECD Principles of Corporate Governance, as well as changes at the EU level prior to 2004. These amendments were thus not a result of a specific monitoring mechanism directly identifying the shortcomings of the code. In ***Greece***, there is no revision system due to the absence of reference code. Statutory rules are monitored by State authorities, as for any other legal provision.

5.4 Member State reactions to code reviews

In several instances, legislation has been introduced or threatened to be introduced when code reviews show that companies do not comply with certain code provisions. In these cases the legislator recognises that the informal influence of the code is insufficient to prompt compliance. For example:

- In ***France*****,** following the publication of the AFEP/MEDEF recommendations concerning executive directors' remuneration in October 2008, the government called on boards of directors of listed companies to adopt the recommendations before the end of 2008. The government threatened that a bill would be passed along similar lines in 2009 if companies did not take on the recommendations[163].

- In ***Germany***, following the persistent non-compliance of companies with the code's provision requiring the disclosure of remuneration on an individual basis, the government introduced this requirement in the law, making the publication of individual information on remuneration mandatory. Additional legal requirement have also been introduced by the recent Act on the Appropriateness of Executive Remuneration. This includes compensation decision process, disclosure, extent of liability insurance, shareholder participation and cooling-off periods between supervisory board and management board mandates.

  In ***Malta*****,** the MFSA, currently involved in a review of the Maltese corporate governance framework, declared that it wished to, "make obligatory all the Principles included in the revised code for Issuers of Listed Securities, after a period of transition." The initial plan was to make a few selected provisions mandatory, and submit the remaining ones to a comply-or-explain regime.

[162] OECD Principles of Corporate Governance, OECD, 2004, available at: www.oecd.org/daf/corporateaffairs/principles/text.
[163] As of early January 2009, all French companies listed in the SBF120 index but one had published the required statement.

6 MONITORING AND ENFORCEMENT OF CORPORATE GOVERNANCE CODES

In a 2006 statement, the ECGF stated that one of the conditions for the comply-or-explain approach to be effective is a high level of transparency regarding companies' corporate governance practices, with coherent and accurate disclosure[164]. As a first step towards ensuring a high level of transparency, Directive 2006/46/EC introduced the requirement for listed companies to publish a corporate governance statement, and established the minimal content of the statement[165]. Individual Member States have provided additional guidance for the content of corporate governance statements in national codes or law.

Due to potential agency problems between management and shareholders (in systems with dispersed ownership) or between majority and minority shareholders (in systems with concentrated ownership), the interests of management and shareholders are not always perfectly aligned. Managers may be reluctant to implement the requirement to publish a corporate governance statement, or might be tempted to implement this purely as a formality. In addition, adopting the comply-or-explain approach may be burdensome in terms of managerial efforts and time. Furthermore, compliance with some transparency requirement may conceivably result in competitive disadvantages for companies.

Therefore, monitoring of disclosure practices and enforcing of disclosure rules may be necessary, in order to attain the level of disclosure needed to indentify agency issues.

Monitoring activity helps to achieve two goals. First, monitoring enables the collection of information about the state of play on a market-wide and company basis. This information allows both the market and the authorities to make more informed decisions on governance aspects of companies and to identify the need for further regulatory developments. Second, public exposure via monitoring procedures may provide companies with an incentive to disclose information.

In addition, the threat of certain enforcement sanctions in case of non-compliance with the comply-or-explain principle should encourage compliance, as breach of the comply-or-explain mechanism may prove more costly (either in financial or reputational terms) than the adherence to this approach.

6.1 Monitoring and enforcement bodies

A wide variety of bodies may be engaged in monitoring and/or enforcing the application of corporate governance codes in terms of comply-or-explain. These can be grouped into:

- **Market-wide monitors** are bodies which are responsible for monitoring compliance with the codes of all or a certain group of companies. In doing so, they inevitably verify compliance with the code by individual companies and are in a position to impose individual sanctions. However, they remain focused on the market as a whole rather than on specific companies. This group of market-wide monitors includes public bodies – financial market authorities (FMA) – or bodies with a public interest mission - stock exchanges[166] - as well as private bodies – trade bodies and professional organisations, financial press, analysts, advisors, and academics. The main difference between public and private bodies is that the former possess legally determined authority and enforcement power, while the latter perform monitoring on an informal and voluntary basis and can only use informal reputational sanctions.

[164] European Corporate Governance Forum, Statement of the European Corporate Governance Forum on the comply-or-explain principle, dated February 22nd, 2006, available at http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf-comply-explain_en.pdf.
[165] See Chapter I-2-2.
[166] Although stock exchanges may in a number of Member States be private bodies, so that their relation with companies may be based on a contractual basis, this analysis will consider them as bodies with a public interest mission, in the sense that they have the authority to impose formal sanctions and enjoy a widely recognized, parapublic status in the market.

- **Company specific monitors** are bodies whose monitoring and enforcement efforts are directed towards individual companies. This can include auditors, boards, shareholders, and other stakeholders such as suppliers, creditors, peers, and others.

Figure I-6-1: **Types of monitoring and enforcement bodies**

Types of monitoring and enforcement bodies	
Market-wide	Financial market authorities Stock exchanges Trade bodies and professional organisations Financial press, analysts and academics
Company specific	Boards Auditors Shareholders and other stakeholders

6.2 Types of monitoring and enforcement activities

Monitoring encompasses a variety of activities involving the observance and analysis of the practical application of code provisions by companies*:*

- ***Availability check*** - verification whether companies have formally declared adherence to a code, and have published corporate governance statements declaring which code provisions they have not followed. The goal of this type of monitoring is simply to verify the availability of information without assessing its quality.

- ***Accuracy check* -** determination of whether code provisions have in fact been followed and whether companies' explanations for deviations provide accurate information.

- ***Informative value check*** - check whether statements of compliance and explanations of the deviations provide enough information to enable market actors to make informed judgements about companies' corporate governance practices.

Availability checks are comparatively easy to perform, especially in the framework of formalised reporting requirements. Accuracy and informative value checks are more complex and difficult to perform as, on the one hand, inaccurate disclosure may be hard to detect, and, on the other hand, some qualitative judgement is required when assessing the informative value of governance statements. The challenges associated with the assessment of the informative value of corporate governance statements are exacerbated by the lack of authoritative interpretation of the content of code provisions[167]. Moreover, monitoring of this type is resource intensive, both in human and financial terms.

Based on the results obtained through their activities, monitors can take actions against non-compliant companies:

- The breach of the requirement to make governance statements publicly available can lead to the imposition of ***formal administrative penalties*** by public enforcement bodies.

- The failure to provide accurate information may give rise to ***administrative*, *criminal*, *and private civil litigation***.

[167] Björn Fasterling, *Challenging "Comply or Explain,"* in Making Capital Markets Work through Corporate Governance ed. by Dr. Madhav Mehra, available at http://www.wcfcg.net/allarticle/20.pdf. In some Member States, drafters of corporate governance codes and other institutions work on providing guidance to companies in the application of codes.

- Deficiencies in terms of informative value of corporate governance statements can, in contrast, usually only be addressed by ***informal public and private enforcement actions***.

The following table provides a short overview of the different monitoring and enforcement methods, and the bodies that can potentially perform them:

Figure I-6-2: **Types of monitoring and enforcement activities**

<table>
<tr><th colspan="2">Types of monitoring and enforcement bodies</th><th>Monitoring activities</th><th colspan="2">Enforcement activities</th></tr>
<tr><td rowspan="4">Market-wide</td><td>Financial market authorities</td><td>Availability
Informative value</td><td colspan="2">Formal and informal penalties</td></tr>
<tr><td>Stock exchanges</td><td>Availability
Informative value</td><td colspan="2">Formal and informal penalties</td></tr>
<tr><td>Trade bodies and professional organisations</td><td>Availability
Informative value</td><td colspan="2">Informal penalties (reputational sanctions)</td></tr>
<tr><td>Financial press, analysts and academics</td><td>Availability
Informative value</td><td colspan="2">Informal penalties (reputational sanctions)</td></tr>
<tr><td rowspan="8">Company specific</td><td>Boards</td><td>Availability
Accuracy
Informative value</td><td colspan="2"></td></tr>
<tr><td>Auditors</td><td>Availability
Accuracy</td><td colspan="2">Note in the auditor’s report
Refusal to certify statements</td></tr>
<tr><td rowspan="6">Shareholders and other stakeholders</td><td rowspan="6">Availability
Accuracy
Informative value</td><td rowspan="2">Private litigation</td><td>Derivative suit</td></tr>
<tr><td>Securities litigation</td></tr>
<tr><td rowspan="4">Exercise of shareholder rights</td><td>Removal of directors</td></tr>
<tr><td>Shareholder decision rights (e.g. say on pay)</td></tr>
<tr><td>Right to table a resolution and ask questions</td></tr>
<tr><td>Divestment</td></tr>
</table>

6.3 Market-wide monitoring and enforcement

6.3.1 Monitoring and enforcement by market-wide monitors (including stock exchanges)

Market-wide monitors (including stock exchanges) are engaged in two types of monitoring: monitoring of the availability of corporate governance statements and monitoring of their informative value. Monitoring and enforcement of the availability of information forms the largest part of their activity, while the informative value assessment is still not very widespread.

Market-wide monitors are normally in charge of controlling how companies comply with the requirement to publish a corporate governance statement. Depending on local legal provisions, they might also check if all mandatory information is disclosed in the statement.

The legal basis to perform availability checks is the following:

- If the requirement to produce a corporate governance statement is stipulated in law, the FMA (or another specialised authority) is usually mandated with the duty to survey compliance.

- If this requirement is incorporated into the listing rules, the stock exchange is entitled to supervise compliance, as non-disclosure would amount to a violation of the listing rules.

In both cases, market-wide monitors possess all standard means to monitor and enforce companies' duty of disclosure. This is usually performed by informally engaging with companies. However, in case of serious non-compliance, official sanctions may potentially be imposed:

- FMAs can issue a public letter, impose a fine, or use other available administrative sanctions available in national law.

- Stock exchanges can react by issuing a reprimand, imposing a fine or, in the most severe cases, delisting the company.

Implementing a strict monitoring process combined with the imposition of strict penalties is, in practice, quite a delicate procedure due to the potential damages it may inflict on investors. Moreover, stock exchanges might be more reluctant to impose sanctions on listed companies than FMAs as stock exchanges also act as service providers to companies.

Monitoring the availability of governance statements, and corresponding enforcement actions

The following are examples of monitoring and enforcement by market-wide monitors (including stock exchanges) related to the availability of information:

- In ***Bulgaria***, the securities regulator FSC is responsible for monitoring company reports. In particular, this includes the timely publication of annual reports, for which administrative penalties can be imposed in case of violation. Corporate governance statements are however not systematically included in annual reports.

- In ***Denmark***, the stock exchange NASDAQ OMX Copenhagen determines whether companies comply with the requirement to publish a corporate governance statement. The stock exchange may approach companies informally, and issue a reprimand if they do not comply. For instance, in 2008, one company received a reprimand for not including a corporate governance statement in its 2007 annual report. This information was made public in an annual surveillance report and published on the stock exchange's website.

- In ***France***, the corporate governance statement needs be included in the annual report, which has to be submitted to the securities regulator AMF. In case of non-submission of the report, the AMF issues a summoning letter to the contravening company and publishes this letter on the official website of the AMF.

- In ***Ireland***, the Irish Stock Exchange has the general power under its Listing Rules to censure, suspend, or cancel the listing of a company that does not adhere to the provisions of the Combined Code. The Irish Stock Exchange is, in turn, regulated by the Financial Regulator, a state body. If the Financial Regulator is dissatisfied with the operation or regulation of the Irish Stock Exchange, it may threaten to withdraw the stock exchange's authorisation or, more pragmatically, use its influence to persuade the stock exchange to change or tighten its procedures and operations. The Financial Regulator hence has an indirect impact on companies' compliance.

- In ***Lithuania***, the corporate governance statement is also incorporated in the annual report, which has to be submitted to the Register of Legal Entities. In case of non-submission, officials of the Register of Legal Entities may impose fines in an amount ranging from LTL 1,000 to LTL 10,000 (approx. EUR 300 to 3,000).

- In ***the United Kingdom***, the securities regulator FSA performs an availability check by routinely sampling a number of annual reports. If a company fails to include a statement in the required form, the FSA may use its authority against the company, including imposing a fine. However, the FSA makes no judgement about the accuracy or adequacy of the compliance statement: it is up to the company's board and to shareholders to make such an evaluation. Therefore, the FSA's review is limited to a formal check, leaving substantive evaluation to shareholders and the market.

Monitoring the informative value of governance statements, and corresponding enforcement actions

Market-wide monitors in several Member States go beyond the formal check of availability of information to monitor the informative value of corporate governance statements.

The legal basis for such monitoring activities is not always apparent, and usually stems from the general mandate of market-wide monitors to supervise financial markets and listed companies. Monitoring activities range from the expression of moral support for the code, to the review of companies' practices or the publication of reports (on a market-wide or an individual basis), to engagement with companies in order to enhance the quality of their reports.

Member State FMAs publish reports in ***Belgium***, ***Estonia***, ***France***, ***Germany***, ***Lithuania***, ***the Netherlands***, ***Portugal***, ***and Spain***. The ***Spanish*** and ***Portuguese*** reports are the most in-depth, where the findings are presented both at market-wide and company levels. In all other cases the reports present results on a market-wide basis and do not mention individual companies. In the Netherlands, Portugal, and Spain, the quality of explanations provided is also discussed, but only on a market-wide basis. Stock exchanges publish reports in ***Denmark***, ***Estonia***, ***Finland***, ***Lithuania***, ***and Luxembourg***; however, with the exception of Luxembourg, these reports are very short and contain limited information.

Figures I-5-3 and I-5-4 summarise the monitoring activities carried out by FMAs and stock exchanges. Of these monitoring systems, the Portuguese and Spanish regimes appear the most developed and are therefore described below in more detail:

- In ***Portugal***, the securities regulator CMVM monitors companies' reports, issues recommendations to companies, and is responsible for ensuring that statutory or regulatory publications are produced by listed companies. The CMVM publishes an annual report on companies' corporate governance statements. The report is extensive and provides information about the individual compliance with the code for all covered companies. In its last report issued in 2008, the CMVM also asked companies to answer a questionnaire containing 36 questions and 306 points relating to their corporate governance practices[168].

- In ***Spain***, the CNMV is in charge of the monitoring proceedings related to corporate governance duties of listed companies. The CNMV's main responsibilities regarding corporate governance issues are:
  - the monitoring of adherence to corporate governance regulations (including the company reports), gathering any additional information it may consider necessary to duly implement its task;
  - the publication of any information it may consider necessary about the extent of compliance of corporate governance duties by listed companies;
  - the initiation and investigation of penalty proceedings concerning corporate governance duties (eg. in case of untrue, false, or misleading information);
  - the imposition of sanctions for infringements concerning corporate governance duties.

  While carrying out its duties, the CNMV annually publishes two extensive reports regarding corporate governance practices of Spanish listed companies (General and IBEX35 indices) [169]. These reports provide information both on a market-wide and on an individual basis.

[168] Annual Report on the Corporate Governance of Listed Companies in Portugal 2008, available at http://www.cmvm.pt/NR/rdonlyres/33DE0BB8-6C6F-4170-8726-020E33738A2D/12030/AnnualReportCorporateGovernanceListedCompaniesPort.pdf.

[169] Corporate Governance Report of Entities with Securities Admitted to Trading on Regulated Markets 2007,available at: http://www.cnmv.es/publicaciones/IAGC2007_e.pdf; Corporate governance of IBEX-35 companies 2008, available at: http://www.cnmv.es/publicaciones/IAGC2008IBEX.PDF.

The publication of reports by market-wide monitors constitutes a very important part of their monitoring activity. By publishing the results of their monitoring activities, market-wide monitors make information more easily accessible for other parties. Moreover, reports on monitoring tend to exemplify good practices. Finally, reports providing an analysis of the explanations given by companies in cases of non-compliance have the potential to shift reporting from mere compliance to more meaningful explanations[170].

In contrast, the enforcement powers of market-wide monitors with respect to the informative value of corporate governance statements are limited. This is partly due to a lack of material to initiate enforcement action, but more importantly, the assessment of informative value implies a great deal of judgement and subjectivity, making the imposition of formal sanctions difficult.

Nevertheless, FMAs may use informal enforcement techniques ranging from informal talks and correspondence with companies providing uninformative explanations, to the "name and shame approach," i.e. publish a public statement that a firm has failed to meet a required standard

Monitoring the accuracy of governance statements, and corresponding enforcement actions

Market-wide monitors almost never[171] systematically check the accuracy of the information[172] disclosed in corporate governance statements. FMAs occasionally initiate investigations in the context of criminal and administrative proceedings related to the publication of inaccurate information; however, their involvement is limited because they usually do not perform accuracy checks of corporate governance statements and therefore do not have enough information to initiate procedures.

[170] Björn Fasterling, *Challenging "Comply or Explain"*, in Making Capital Markets Work through Corporate Governance ed. by Dr Madhav Mehra, available at http://www.wcfcg.net/allarticle/20.pdf.
[171] The Italian Consob was initially granted the power to judge the accuracy of the information disclosed by companies with regard to their compliance with the corporate governance code, and to impose sanctions. However, these powers were repealed in 2006 due to the difficulty to perform such controls.
[172] The monitoring of accuracy is understood in this document as the intentional exercise check of the accuracy of corporate governance information by a monitor. This does not include the cases when a monitor would react on some evident cases of inaccurate information without actually undertaking a targeted analysis.

Figure I-6-3: **Monitoring of company compliance with corporate governance code by financial market authorities**

	Monitoring of compliance by financial market authorities				
MS	Financial market authority	Monitoring activity	Published reports	Level of analysis	Language
BE	Banking, Finance and Insurance Commission	Formal monitoring Analysis of reports and publication of results	1998-1999, 2006 Comparative survey 2004 Information on corporate governance	Market level	French and Dutch
BG	Financial Supervision Commission	Formal monitoring			
EE	Financial Supervision Authority	Comments to the companies Analysis of reports and publication of results	2008 Overview on the listed companies' Corporate Governance Recommendations Reports 2006-2007	Market level	Estonian
FI	Financial Supervisory Authority	Formal monitoring			
FR	AMF	Formal monitoring Analysis of reports and publication of results	2004- 2008 annual reports (based on public disclosure and interviews with the companies)	Market level	English and French
DE	Government Commission on the German Corporate Governance Code	Analysis of reports and publication of results	2003-2008 annual surveys by the Berlin Centre of Corporate Governance	Market level	English and German
HU	Financial Supervisory Authority	Formal monitoring			
IT	Consob	General duty to monitor the transparency of the markets and correctness of information			
LV	Financial and Capital Markets Commission	Formal monitoring			
LT	Lithuanian Securities Commission	Analysis of reports and publication of results	2007 Report	Market level	Lithuanian
MT	MFSA	Review of the corporate governance reports and feedback and comments when necessary May require a more stringent and detailed level of information to be disclosed			

MS	Financial market authority	Monitoring activity	Published reports	Level of analysis	Language
NL	Monitoring Committee	Analysis of reports and publication of results	2005, 2006, 2007, 2008 annual reports 2008 Evaluation Report of three years monitoring	Market level Substantive (limited)	English and Dutch, older only in Dutch
	Authority for the Financial Markets (AFM)	Supervises compliance with the standards for financial reporting, which include the standards provided in the 2003 code to the extent that companies have stated that the standards will be applied			
PT	CMVM	Analysis of reports and publication of results Recommendations to companies	1999-2002 annual reports, 2006-2008 annual report	Market and individual level Substantive	Portuguese
SK	National Bank of Slovakia	Supervises the level of compliance with the law and the stock exchange rules			
SI	Securities Market Agency	Monitors the accuracy of the statement on corporate governance. The aim of the monitoring is to find out whether companies reveal truthfully, which stipulations of such code are not complied with, and whether they give explanation for the deviations			
ES	CNMV	Monitors corporate governance regulations (including the company reports), Gathers any additional information it may consider necessary to duly implement its task, Publishes any information it may consider necessary about the extent of compliance of corporate governance duties by listed companies, Initiates and investigates penalty proceedings concerning corporate governance duties, Imposes sanctions for the infringements concerning corporate governance duties	2004 - 2007 Corporate governance reports of entities with securities admitted to trading in regulated market 2005-2007 annual reports on corporate governance of Ibex-35 companies	Market and individual level Substantive	Spanish and English
UK	FSA	Formal monitoring (no reported instances of the FSA taking action)			

Figure I-6-4: **Monitoring of company compliance with corporate governance code by stock exchanges**

Monitoring of compliance by stock exchanges				
MS	**Monitoring activity**	**Published reports**	**Level of analysis**	**Language**
BG	Instruct and sanction in relation of shortcomings in corporate governance report			
CY	Administrative fines for breach of the provisions of the code Refusal to admit to listing if the company does not provide substantial explanations for non-compliance.			
DK	Formal monitoring (reprimands in case the company does not publish corporate governance statement) Short overview of company practices in the annual report	Annual report of OMX Exchange	Market level (limited)	English
EE	Guidelines to companies Short overview of company practices in the annual report	Annual report of OMX Exchange	Market level (limited)	English
FI	Contacts the companies with deficiencies either informally or in writing, and can also impose formal disciplinary sanctions in serious cases Short overview of companies' practice in the annual report on market basis Regular studies on compliance	Annual report of OMX Exchange	Market level (limited)	English
IE	Formal monitoring			
IT	Formal monitoring			
LV	Formal monitoring			
LT	Short overview of companies' practice in the annual report on market basis Studies on compliance	Annual report of OMX Exchange	Market level (limited)	English
LU	Formal monitoring Analysis of reports and publication of results	2006 and 2007 Reports	Market level	French
PL	Formal monitoring			
RO	Formal check (but no sanctions foreseen)			
SI	Formal monitoring			
SE	Supervision of some aspects of the companies' compliance with the code Short overview of company practices in the annual report	Annual report of OMX Exchange	Market level (limited	English

6.3.2 Monitoring and enforcement by market-wide private monitors

Private organisations play an important monitoring role in several Member States. In ***France*** and ***Sweden*** for instance, codes were developed by professional organisations which carry out the duty to monitor compliance with those codes. Although the powers of such organisations are usually not legally defined, and even though they do not have legal enforcement authority, their efforts have a significant influence and are often acknowledged both by regulators and market participants. As an illustration:

- In ***France***, business organisations AFEP-MEDEF[173] verify the application of the French code and write to the management of individual companies that do not apply recommendations without good reasons.

- In ***Sweden***, the Corporate Governance Board publishes an extensive yearly report in which it *inter alia* assesses the quality of the explanations for deviations provided by companies.

In other instances, monitoring is performed by business consultancy companies such as Deloitte, Grant Thornton, and others[174]. The results of such monitoring are not publicly available in all cases. Academic institutions also run research projects related to compliance issues, however not on a regular basis.

In terms of enforcement, market-wide private monitors usually have limited powers. As professional organisations and trade bodies, they may only urge companies to report on and dutifully apply the code by way of comply-or-explain by cancelling their membership or using the "name and shame" strategy.

Table I-5-5 presents some examples of monitoring practices by market-wide private monitors:

Figure I-6-5: **Monitoring by market-wide private parties (selected examples)**

MS	Institution	Monitoring activities and published results
BG	Bulgarian Academy of Sciences' Institute of Economics (*commissioned by the World Bank*)	Ongoing research on implementation of the code (2007-2009)
IT	Assonime	Annual report since 2001; Handbook on corporate governance Reports
IE	eg. Grant Thornton	Annual Corporate Governance Review
FR	AFEP-MEDEF	Annual report; Engagement with companies
SI	INEKO (private body), Central European Governance Association	Statistics and information on the level of compliance (2001)
ES	Instituto de Consejeros-Administradores	Periodically reports regarding the progresses on companies' governance
SE	The Corporate Governance Board	Annual report since 2006
UK	eg. Deloitte and Grant Thornton	Annual compliance reports

[173] Note that the AFEP/MEDEF is also the drafter of the code in France.
[174] Consultancies publishing this type of reports probably do so for communication or knowledge sharing purposes.

6.4 Company specific monitoring and enforcement

6.4.1 Monitoring and enforcement by boards of directors and supervisory boards

The primary role of boards is arguably to be the leading and controlling body of the company. Regardless of which board structure is employed, the role of the board is to "ensure strategic guidance of a company, effective monitoring of management, and remain accountable to the company and the shareholders."[175] These provisions are reflected in most national corporate governance codes.

The fiduciary duty of board members to companies includes ensuring that the company has a well balanced corporate governance system, and that the code is complied with or, in case of non-compliance, that informative and accurate explanations are provided.

Directive 2006/46/EC has harmonised the minimal requirements concerning boards' involvement in formally monitoring the availability of information on corporate governance practices. According to the Directive, boards have a duty to ensure that corporate governance statements (either as a part of the annual report or as a separate document) are drawn up and published in accordance with the Directive's requirements and, where applicable, in accordance with international accounting standards.

The duty to publish a statement exposes boards to the risk of liability for failure in formal monitoring, and also encourages boards to focus on the substance of their corporate governance practices. First, there is the risk of loss of reputation and the threat of divestment by discontented shareholders. Second, directors may be liable towards the company if the statement is not published, and also liable toward third parties if the statement contains inaccurate or misleading information. Finally, this may – depending on the national law - trigger the intervention of the securities regulator if it is in charge of the supervision of company disclosure.

Boards are therefore, in the majority of European jurisdictions, given the leading role in ensuring compliance with corporate governance codes. However, when there are controlling shareholders or there is a highly dispersed ownership structure with limited institutional shareholding, boards may not be sufficiently independent or capable of protecting the interests of all shareholders, particularly minority shareholders. The problem may be amplified if shareholders are passive with regard to observance of the governance code, which may be the result of both material (such as the issue of collective action) and legal hurdles for launching an action to protect their rights against board members. Therefore, although the monitoring performed by boards is the central monitoring device in a majority of legal systems across the EU, it might prove insufficient.

6.4.2 Monitoring and enforcement by auditors

Auditors may be considered effective monitoring bodies because they often have a deep and profound knowledge of companies' functioning and governance practices. However, before the recent harmonisation by Directive 2006/46/EC, the involvement of auditors in the monitoring of compliance with the code varied significantly from one Member State to another:

- In Member States where the corporate governance statement is included in the annual report and accounts, the auditor was involved in monitoring as a part of its duty to certify the annual report and accounts[176].
- In other Member States, the involvement of the auditor was limited to the verification of the figures mentioned in the report, or only certain aspects of the corporate governance statement[177].

[175] OECD Principles of Corporate Governance, dated 2004, available at www.oecd.org/daf/corporateaffairs/principles/text.
[176] For example, in Germany the corporate governance statement is included in the annual report. Therefore, the auditor has to perform a formal review of the corporate governance declaration. The review is limited to checking whether the declaration has been delivered and whether it is accessible to shareholders.
[177] In France, the auditors have to examine the compliance statements in terms of disclosure on internal control structures and financial reporting processes. In the UK, auditors verify if the corporate governance statement reflects the company's

- Some Member States did not provide for any involvement by the auditor at all[178].

In all cases the auditor's review is quite limited; at most, a formal monitoring is implied where the auditor only certifies that the company complies with the requirement to include the statement, and that the statement is consistent with the rest of the annual filing[179]. The auditor does not engage in monitoring the accuracy and informative value of the corporate governance statement.

The diversity of national regulations has been partly harmonised by Directive 2006/46/EC. The Directive imposes the requirement for statutory auditors to formally evaluate compliance with the requirement to publish a corporate governance statement. This requirement applies whether the statement is published as part of the annual report or in a separate document or not at all. As a result, statutory auditors in all Member States are now obliged to assess the availability of information.

The Directive does not provide instructions on the implementation of this monitoring duty by auditors, and thus it does not specify how auditors should act in case of violation. The practice in some Member States shows that often, the auditor will try to resolve the matter informally with the company management, pointing out the deficiencies and proposing remedies. However, if the company does not respond, the auditor would have to explain the deficiencies in its note to the accounts.

So far, monitoring activities by auditors have at best been limited to the monitoring of the availability of information. It is generally not the task of auditors to control the accuracy and informative value of corporate governance statements.

6.4.3 Monitoring and enforcement by shareholders

As the primary beneficiaries of corporate governance, shareholders have a crucial interest in monitoring and enforcing the thorough application of corporate governance codes by way of comply-or-explain.

In this task, shareholders, and specifically, institutional investors, face the difficult situation of having to deal with a large universe of companies, spread around the world, with diverse corporate governance traditions, referring to different codes, and reporting in a variety of languages. Monitoring companies' application of corporate governance codes is not an effortless exercise, and institutional shareholders often contract with service providers to help them in their investment/divestment decisions (rating agencies), and post-investment decisions (proxy-voting advisors).

However, monitoring is often not sufficient to ensure that companies follow the comply-or-explain approach. If a company does not fulfil its duties, shareholders can use divestment, informal enforcement via the exercise of shareholder rights, or formal legal enforcement in the form of civil litigation.

Divestment

Shareholders may express their dissatisfaction with the corporate governance practices of companies by selling their shares. The sale of stock tends to depress the stock price, if the holding is sufficient to be market moving.

Shareholders may be most inclined to use this controlling device when their cost of monitoring is higher than the cost of divestment. This is typically the case for investors holding minor stakes in

compliance with nine provisions of the Combined Code and have to report if it does not. They are not required to consider whether the board's statement on internal control covers all risks and controls, or to form an opinion about the effectiveness of the company's corporate governance procedures or its risk and control procedures.

[178] For example, in Belgium.

[179] Eddy Wymeersch, *Corporate Governance Codes and their Implementation*, Ghent university Working Paper 2006-10, dated September 2006; available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=931100.

companies. However, if a shareholder holds larger amounts of stock, the divestment option might be unavailable due to the specific investment policy or contractual limitations, or costly due to the impact of the block sale on the share price. Therefore, larger investors' monitoring and enforcement options would often be limited to the exercise of shareholder rights

Exercise of voting rights

Company law may provide shareholders with a number of important rights in order to impose corporate governance standards, including the right to appoint and remove directors, the right to set the remuneration of board members and management, and the *ex ante* approval of important transactions. In addition, following requirement of Directive 2007/36/EC on shareholder rights, shareholders are usually entitled to table resolutions, ask questions during general meetings, and to receive an answer, which enables them to engage in dialogue with the management.

There are numerous examples where shareholders have successfully exercised their monitoring and enforcement powers in the corporate governance arena. The following examples of investor activism in the area of executive remuneration in 2009 illustrate the point:

- In the ***United Kingdom*** shareholders at Shell, Provident Financial and Bellway all rejected the companies' 2008 remuneration reports proposed via an advisory vote.

- Continental European-based companies including Volvo (**Sweden**), Heineken, and Randstad Holding (***the Netherlands***), removed or amended contentious remuneration proposals from their agendas prior to the general shareholders' meeting, in anticipation of possible rejection by their shareholders.

However, the empowerment of shareholders does not always lead to efficient monitoring and adequate enforcement by shareholders themselves. Minority shareholders often have stakes that are too small to justify the implementation of a monitoring strategy to ensure informed voting. It may be cheaper for them to sell their holdings if they are not satisfied with the company's corporate governance practices. Larger investors (e.g. institutional shareholders) might be interested in monitoring companies' practices, however, once the monitoring efforts are performed by one investor, it becomes known to everybody, as the results of this monitoring are reflected in the voting practices of the investigating investor. Therefore, other investors do not have to spend resources on monitoring and can free-ride on the efforts of the initial monitor. This behaviour may discourage the initial monitor to perform its monitoring in the first place.

Some Member States have started encouraging shareholders to take a more active role in monitoring the behaviour of companies they have invested in. As mentioned above[180], France, the Netherlands, Portugal, and, to a lesser extent, the United Kingdom have put a number of reporting obligations in place for institutional investors to report on their voting policy and activity.

In order to ensure that institutional investors actually do abide by their obligations (or recommendations, in the case of the United Kingdom), and take an active role in the monitoring of company practices, France and the United Kingdom have put some structures in place to inform the public on investors' activities:

- ***In France***, the securities regulator AMF publishes annual reports on voting policies and the exercise of voting rights of a panel of 12 major institutional investors, analysing the content of the main aspects of these investors' voting policies and voting records[181].

  Concerning voting policies, the 2008 report (on financial year 2006) lists that only one out of 12 investors has a policy not to exercise its voting rights[182]. The report notes that three investors limit their voting activity to French listed companies, for cost and logistics

[180] See Chapter I–3.2.1.
[181] Contrôle sur pièces des politiques de vote et des rapports sur l'exercice des droits de vote en 2006 par les sociétés de gestion, dated March 3rd, 2008; available in French at : http://www.amf-france.org/documents/general/8204_1.pdf.
[182] The report mentions that this policy was well founded, as the investor was strictly investing in other UCITS and not directly in corporate stock.

reasons. The most common threshold above which investors exercise their voting rights is set at 2 percent of share capital ownership in the company invested in (up to 5 percent in one case). Some set this threshold in relation to the proportion taken by the investment in the investor's complete portfolio (once again, thresholds vary between 2 and 5 percent of assets under management). Finally, all but one of the 12 investors' policies have provisions to prevent and solve conflicts of interest.

In terms of voting records, all investors disclose the general meetings at which they exercised their voting rights. Five investors have at some point diverged from their voting policy, and provided explanations in that regard: all reported deviations were categorised as isolated votes related to case-by-case decisions on specific items. Finally, the report notes that postal voting was the most popular method for the 12 investors exercised voting rights.

French asset management association AFG also publishes an annual report on the exercise of their voting rights by approximately 50 institutional investors[183].

- In ***the United Kingdom***, the publication of a voting policy and voting records by institutional investors is only a recommendation of Section 2 of the British code of corporate governance. No formal monitoring of the application of this recommendation has been put in place, but some bodies have reported on this aspect on an *ad hoc* basis. The Institutional Shareholders' Committee published some reports[184], but no regular reporting to the public is currently undertaken.

- In ***Portugal***, institutional shareholders are legally bound to register their voting records with CMVM, which, in turn, should publish them on its website. CMVM, however, seems to have stopped publishing these voting records on its website around 2006.

Legal actions

Shareholders may finally want to use their rights of action deriving from general company law, which typically provide two action types to reprimand the breaches of disclosure laws (misrepresentation): derivative suit and securities litigation.

With a derivative action, shareholders initiate litigation against the directors on the company's behalf. In most systems there are considerable legal and financial hurdles for shareholders to start the proceeding, and, even in the case of success, damages are awarded to the company and not directly to shareholders. Therefore, derivative actions are quite rare, especially in the sphere of corporate governance.

For securities litigation, national laws give shareholders the right to launch an action against the company for breach of disclosure requirements. However, in practice, the possibilities of shareholders are limited, primarily because of three considerations:

- Difficulty to prove the causal relationship between breaches of disclosure duties and suffered damages, such as depreciation of the stock price. It is inherently difficult, if not impossible, to determine what has influenced the decline of the stock price and to what extent, especially in connection with information contained in the corporate governance statement;

- Unavailability in a number of Member States of a mechanism to aggregate individual claims (group or class actions);

[183] AFG, *Exercice des droits de vote par les sociétés de gestion en 2008*, dated May 26th, 2009; available in French at : http://www.afg.asso.fr/index.php?option=com_docman&task=doc_download&gid=1638&Itemid=231&lang=fr.

[184] ISC, *Review of the Institutional Shareholders' Committee Statement of Principles in the Responsibilities of Institutional Shareholders and Agents*, dated September 2005; available at: http://www.ivis.co.uk/PDF/6.1a_Review_of_ISC_Statement_of_Principles.pdf .

- Inexperience of national courts in some Member States in hearing cases involving listed companies[185].

Due to the above-mentioned reasons, shareholder engagement in private litigation is limited, even in jurisdictions with dispersed ownership and a strong institutional shareholder base like the United Kingdom. Indeed, evidence suggests that, in the United Kingdom, over the 1990-2006 period, there were only three reported judgements in which a shareholder action was brought to court in relation to misfeasance by directors of a listed company[186].

6.5 Use of standard forms for corporate governance reporting

Aside from the direct monitoring of companies' compliance with codes, market-wide monitors perform activities which facilitate monitoring by shareholders. An example of such an activity is the creation of standard forms for corporate governance reporting. The use of standard forms by companies ensures that all the required information is disclosed, and reduces the costs and complexity of monitoring for all different monitoring bodies. It makes the information easier to locate, compare, and assess. Nevertheless, corporate governance actors also point out that improperly constructed standard forms may lead to a box-ticking approach and boiler-plate disclosure practices.

The prevailing practice is that no standard form of corporate governance report (statement) is available among Member States. In most, codes or legal acts lay some minimum requirements for the content of the statement and its publication procedure. There is however usually no template the companies may or must follow.

In ***Estonia***, ***Hungary***, ***Italy***, ***Lithuania***, ***Portugal***, ***Slovakia***, ***and Spain***, however, market-wide monitors have introduced mandatory standard forms of corporate governance reporting[187].

- The ***Spanish*** model of annual corporate governance reporting for listed companies is the most comprehensive and instructive. The template consists of parts A to G. Part F is dedicated to the degree of compliance with corporate governance provisions. It contains a list of all code provisions. The company has to state to what extent it complies with or diverges from each of the code recommendations. In the event of non-compliance with a recommendation, the company has to explain the recommendations, rules, practices, or criteria applied. Other parts cover specific subjects and contain questions to be answered and tables to be completed by the companies.

- In ***Estonia*** and ***Lithuania***, the stock exchange has developed a form for the disclosure of compliance with the relevant codes. The form contains a table which lists code provisions and companies are required to state "yes," "no" or "not applicable" in respect to each provision. In cases when a company does not comply with certain provisions, it has to provide an explanation in a separate cell.

- In ***Hungary***, the code contains, in its Appendix 1, details on the information to be included in company's report, and Appendix 2 lays down the format for the Corporate Governance Declaration on Compliance with the Corporate Governance Recommendations and Suggestions. This consists of two tables to be completed by the company. Both tables list all recommendations and suggestions of the code.

[185] For example, in Bulgaria, shareholders can use these causes of action, direct or derivative (e.g. mismanagement, which may relate to bad corporate practices). However, investor-driven litigation is still very rare. Expectations are that courts will not be quick enough when hearing cases, that cost of litigation may be prohibitive, and that civil courts are not yet well trained to adjudicate in cases involving the capital markets. *Ex post facto* remedies (e.g. the award of damages in a civil court) are rare since courts are not widely involved in hearing cases related to listed companies.

[186] John Armour, *Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment*, ECGI - Law Working Paper No. 106/2008, dated April 2008; available at SSRN: http://ssrn.com/abstract=1133542.

[187] Note that in Bulgaria, a number of initiatives currently envisage the introduction of a standard form of reporting: an investor association launched guidelines requiring standard corporate governance reporting; and the Taskforce for the Corporate Governance Code agreed on the implementation of a scorecard for self-evaluation of corporate governance code compliance by boards of directors. This scorecard, which could be considered a standard form of corporate governance reporting, is likely to be introduced shortly.

The first table is dedicated to the level of compliance with the code recommendations. Companies should indicate whether they apply the relevant recommendation or not, and if not, should provide the reasons for not doing so. The second table is meant to document the level of compliance with suggestions. In this case, companies should indicate whether the relevant suggestions of the code are applied or not, but are not obliged to give explanations when the answer is negative. Information should be provided on every provision mentioned in the code. In Hungary this results in an extreme level of detail, as companies are obliged to provide explanations in respect to every subparagraph of each code article.

In ***Italy, Portugal, and Slovakia*** standard forms exist but are not mandatory:

- The ***Italian*** stock exchange has published an optional corporate governance report form in order to help companies in providing details on their governance structure, and to help the market compare the extent to which listed companies comply with the code. However, the form is not widely used by companies.

- In ***Portugal,*** the securities supervisor has developed a Framework for the Report on Corporate Governance. It suggests that companies include a statement of compliance as a chapter of the company's report on corporate governance, where companies have to list the CMVM corporate governance recommendations with which they comply or not. Non-compliance with CMVM recommendations must be appropriately explained. The Framework for the Report on Corporate Governance further provides a detailed list of items which have to be included in the report, divided into chapters. However, in practice not all companies precisely follow the preset structure of the chapters.

- In ***Slovakia,*** there is a pro-forma statement for corporate governance compliance. The form is not mandatory and simply seeks to provide companies with an idea of the content of a possible corporate governance statement. It covers a number of subjects, but does not require companies to explain deviations from code recommendations, neither in general terms nor on a provision-per-provision basis.

7 SUMMARY OF FINDINGS

The results of the legal review may be summarised as follows:

7.1 Relationship between EU legislation, national legislation and codes

- All Member States but two – Greece and Ireland - have a national reference corporate governance code. These codes differ with regard to their drafters, scope and the level of details.

- The requirement to apply a code on a comply-or-explain basis is harmonised at the EU level by Directive 2006/46/EC. It introduces the requirement for companies to publish a comply-or-explain based corporate governance statement and provide information on a series of corporate governance matters - or alternatively allows companies to report on self-defined corporate governance principles which however need to be made public. Additionally, the Directive has harmonised the responsibilities and liability of boards and auditors with respect to the publication of corporate governance statements.

- Directive 2006/46/EC has been implemented in the majority of the EU Member States (except in Belgium, Greece, and Ireland) either by law, securities regulation or listing rules, or by reference to either of these instruments to such a requirement already existing in the code itself.

- Differences in the implementation of Directive 2006/46/EC can lead to the situation whereby a company might find itself bound to comply either with several different codes or with none at all. To remediate this situation the European Corporate Governance Forum proposed to adopt the following rules:

  - In case the Member State of registered seat and the Member State of primary listing are different, the company should choose a corporate governance code applied in either the Member State of its registered seat, or the Member State of its primary share listing.

  - A Member State can only require that a company that is either registered in that Member State, or the shares of which are admitted to trading on a regulated market in that Member State, but which applies another Member State's corporate governance code, explains in what significant ways the actual corporate practices of that company deviate from those set out in the Member State's corporate governance code.

- Issues relating to boards of directors are mostly not regulated at the EU level. However, some elements have been touched upon by EU Recommendation 2005/162/EC which aims to eliminate and prevent conflicts of interests within boards of directors. The suggestions of the Recommendation were implemented by most Member States.

- At national level elements regarding the structure, size, election and dismissal, mission and functions of the board are usually dealt with by company law. Some codes also contain detailed provisions.

- The topic of independence of board members and board committees is mainly dealt with in corporate governance codes. The majority of the codes contain a number of exclusionary criteria on the model of Annex II of EU Recommendation 2005/162/EC. However, there are considerable discrepancies in the stringency of independence definitions from one Member State to the other.

- Directive 2006/43/EC obliges companies to establish audit committees and provides rules on audit committee composition and functioning. However, as of drafting date of this Study, a number of Member States had not yet implemented the Directive in their own national frameworks.

- Provisions on remuneration and nomination committees are still deeply rooted in national corporate governance codes, rather than in European or national legislation.

- The issues relating to executive remuneration are mostly not regulated at the EU level. However, some elements have been touched upon by EU Recommendations 2004/913/EC and 2009/385/EC. The level of application of Recommendation 2004/913/EC is reported to be satisfactory with the exception of the provisions on shareholder vote on remuneration policy.

- The parameters of internal control and risk management systems are based on the minimal requirements of two European Directives 2006/43/EC and 2006/46/EC. They are further detailed in corporate governance codes or separate guidelines. European legislation establishes the duty for audit committees (or alternative bodies) to monitor the effectiveness of company internal control, internal audit (if any), and risk management systems, and internal control and risk management reporting in their corporate governance statement.

- Statutory audit is mostly harmonised at the EU level. Directive 78/660/EEC (4th Company Law Directive) sets the requirement for companies to have their annual accounts audited by statutory auditors. Since then, the subsequent amendments to this Directive, including Directive 2006/43/EC, have harmonised the provisions on auditors, accounting standards and report content across the Union.

- The issue of procedural shareholder rights is subject to a harmonisation at the EU level by Directive 2007/36/EC, and at national regulation either via legislation or corporate governance codes.

- Although envisaged at the EU level in 2003, the adoption of obligations for institutional investors to disclose their investment and voting policy as well as voting records are still subject to national initiatives. Only a handful of Member States (France, the Netherlands and Portugal) have implemented legal requirements in this regard. The United Kingdom has introduced a non-binding section (Section 2) on institutional investors in its Combined Code.

7.2 Updates to the codes

- In almost all Member States, codes are regularly updated. This confirms the notion of the codes as flexible but also living instruments, which adapt to changing economic and social realities.

- In six Member States (Austria, Bulgaria, Germany, the Netherlands, Romania and the United Kingdom), there are formalised procedures for the update of the codes. In these Member States, updates tend to be more regular and frequent.

- In all other Member States, mechanisms for code updates are usually informal and *ad hoc*. In some Member States the general requirement to update the code is stated in the code; in others, there is no mandate for such updates. However, in both instances, codes are in practice updated from time to time.

- Certain Members States respond to non-compliance with specific corporate governance code provisions by incorporating these provisions into the law.

7.3 Monitoring and enforcement of corporate governance codes

- The minimal common standards for the formal monitoring of company compliance with codes are laid down in EU Directive 2006/46/EC, which identifies the board and the auditor as the main bodies responsible for ensuring that the corporate governance statement is produced. However, at Member State level, monitoring systems are quite divergent.

- Market-wide monitors (including stock exchanges) mainly monitor the availability of information on corporate governance. In some cases they also perform some analysis of the informative value of corporate governance statements and publish the results thereof. However, in only a few cases does this analysis contain information about companies' compliance on an individual basis. Financial market authorities tend to be more active monitors than stock exchanges.

- Monitoring by market-wide monitors is more common in Member States where block holders are widespread and where there is limited ownership by institutional investors (e.g. Spain). In those Member States, market-wide monitoring balances the absence of effective monitoring by shareholders.

- Only in a very limited number of Member States (France, the Netherlands, Portugal, and to a lesser extent the United Kingdom) are shareholders encouraged to adopt a more active monitoring role via the publication of their involvement in voting at general meetings.

- Standard formats for the disclosure of compliance by companies serve as a useful device to facilitate the collection and processing of information by all market participants.

CHAPTER II – ANALYSIS OF COMPANY PRACTICE

1 INTRODUCTION

This chapter of the Study will analyse company practice with respect to corporate governance codes, board of directors, and executive remuneration. More specifically, it will describe the availability and quality of explanations for deviation from the corporate governance codes given by companies. Further, it will look at company practice with respect to the election of board members, composition and functioning of board committees, and disclosure and practices regarding executive remuneration.

- This chapter will aim to answer the following questions:
- What explanations do companies provide concerning their compliance with corporate governance codes?
- To what extent do companies provide justifications where they deviate from the codes they refer to concerning the independence of directors?
- How do the mechanisms in place deal with the situation where there is a controlling shareholder in a company? Are there, e.g., rules on a specific role of the board/the independent directors in these cases, or do other arrangements apply?
- What possibilities do shareholders have to influence board composition? Can they only vote on entire candidate lists, or are nominees presented for shareholder approval on an individual basis?
- Do companies publish clear and understandable remuneration statements?
- What are the applicable rules on audit committees (composition, duties, etc.) both in company law/codes as well as at individual companies? What role and responsibilities have companies assigned to the audit committee and management regarding internal control?

Methodology

As requested by the European Commission in the invitation to tender, the content of this chapter is based on an analysis of an original sample of 270 companies over 18 Member States, with 15 companies per Member State. A further breakdown of the companies in this sample is as follows:

- *The first five listed companies by capitalization for each Member State, and*
- *10 mid cap companies.*

Sample	Large-cap	Mid-cap	Total
18 Member States	74 companies	196 companies	270 companies

All statistics at the EU level are based on analysis of the sample of 270 companies listed in 18 EU Member States: Belgium, Bulgaria, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, the Netherlands, Poland, Portugal, Spain, Sweden, and the United Kingdom. 74 of the sample companies are large-caps with a market capitalisation of at least EUR 2 billion, and 196 are mid-caps with a market capitalisation lower than EUR 2bn[188].

[188] See Annex 2 for the methodology on classifying large-cap companies and mid-cap companies. In most Member States, we identified five large-cap companies and ten mid-cap companies. For Bulgaria and Estonia, no large-cap companies were identified. In Hungary two, in Luxembourg three, and in Ireland four large-cap companies were identified.

2 COMPLY-OR-EXPLAIN INFORMATION

This section presents findings on the number of companies referring to a corporate governance document. It also provides details concerning the extent to which companies referring to a corporate governance document also provide comply-or-explain information. Finally, it examines the areas of explanation and the quality of the explanations from both at EU and a market-specific level.

Starting with the Cadbury Report in 1992, European Member States launched initiatives to set up similar codes of best practice for their markets in the 1990s and 2000s. In 2006, Directive 2006/46/EC introduced the requirement for Member State companies to publish a corporate governance statement. The statement should include information about which code the company applies, if any, on a comply-or-explain basis. The Directive does not, however, set any reference parameters concerning the minimum quality or content of the corporate governance code. In addition, Member States have taken different paths to enforce the reference to a code and its application. Corporate governance codes and the comply-or-explain principle have, in practice, been implemented by law, securities regulation or listing rules, or by the code itself[189]. The obligation to publish such corporate governance statement entered into force on September 5th 2008.

2.1 References to corporate governance documents

Of the 18 markets examined in this part of the Study, only Greece has not adopted a corporate governance code[190]. 16 markets have national corporate governance codes. In addition, one market, Ireland, has chosen to adopt the UK Combined Code as its national corporate governance code.

Of the 270 companies analysed, 255 (94 percent) refer to at least one corporate governance document in their annual report. Of the 15 companies that do not mention any corporate governance document, seven are incorporated in Greece, the only market in this Study that has not adopted a corporate governance code. The remaining eight companies not referring to a corporate governance document are incorporated in Bulgaria (four companies), Luxembourg (three companies), and Italy (one company). Bulgaria and Luxembourg were amongst the last Member States to adopt a corporate governance code[191]. 14 out of 15 companies not referring to any corporate governance reference documents are mid-cap companies.

The documents used to collect data in France were published by companies during a period when no comply-or-explain process existed. Therefore, the explanations provided by French companies relevant to this Study are minimal. As for Bulgaria, the obligation to report on the national corporate governance code entered into force in 2008. Therefore, only a minority of Bulgarian companies have disclosed information relevant to this Study.

Most companies refer only to one corporate governance document. However, 43 companies (16 percent) refer to two corporate governance documents, and seven companies (3 percent) refer to three.

Of all companies referring to at least one corporate governance document:

- 242 companies refer to their national corporate governance code.
- 9 companies refer to the national corporate governance code of another market. Two of those companies are domiciled in one Member State but refer to another Member State's national code, whereas the remaining seven companies refer to two national codes.
- 5 companies refer to the OECD corporate governance code[192].

[189] For more information regarding comply-or-explain at the European level, see Chapter I-2.5. Directive 2006/46/EC is available at http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_224/l_22420060816en00010007.pdf.
[190] In Greece, legislation on corporate governance has been implemented in lieu of a Code.
[191] For more information regarding the adoption of corporate governance guidelines and codes, see Chapter I-2.1.
[192] Three companies referring to the OECD guidelines are situated in Bulgaria; one company is situated in France, and one company is situated in Portugal. There is furthermore one additional company noted as referring to international

- 55 companies refer to another corporate governance document. These companies can generally be divided into three main categories:
  - companies referring to a national law related to their business activities in an area of public interest (2 companies);
  - companies referring to a national corporate governance law or national listing rules of the country where the company is domiciled (30 companies);
  - companies referring to foreign listing rules (23 companies).

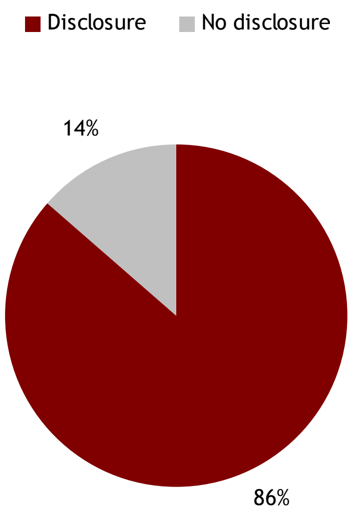
Of the 23 companies referring to foreign listing rules, 19 are considered large-cap companies. These companies are domiciled in no less than 11 Member States (out of 18 Member States researched). However, the largest number of these companies can be found in the Netherlands (4 out of 5 large-caps) and the UK (5 out of 5 large-caps).

References to other governance documents are identified particularly in Sweden (where 10 out of 15 companies refer to the listing agreement with OMX Nordic Exchange Stockholm) and Bulgaria (where 8 out of 15 companies refer to the Law on Public Offering of Securities and / or the Internal Corporate Governance Program). In Greece, 8 out of 15 companies refer to the national corporate governance law - Law 3016/2002 on Corporate Governance.

2.2 Comply-or-explain disclosure

In the comply-or-explain system, which has been adopted by most markets, companies have the choice of either complying with the code provisions or explaining why they deviate. Companies referring to a corporate governance document, as described above, do not all necessarily provide comply-or-explain information on a code.

Figure II-2-1: **Disclosure of comply-or-explain information in EU - general**



Proportion of companies disclosing:

At the EU level, 86 percent of the companies (233 companies) provide comply-or-explain information on a corporate governance code. For each company disclosing comply-or-explain information, the main code they refer to was identified as the reference corporate governance code. In a majority of the markets studied, all companies disclose comply-or-explain information. However, not a single Greek company discloses comply-or-explain information, and only two Bulgarian companies do.

When looking at the sample of 74 large-cap companies alone, 92 percent disclose comply-or-explain information[193], whereas the proportion of companies disclosing comply-or-explain information for the 196 mid-cap companies is 84 percent[194].

A small minority of companies disclose comply-or-explain information on two codes. Five companies (four large-cap companies and one mid-cap company) disclose comply-or-explain information on two national

corporate governance standards: one French company referred to the European Commission Recommendation of February 15, 2005 concerning the role of Directors.

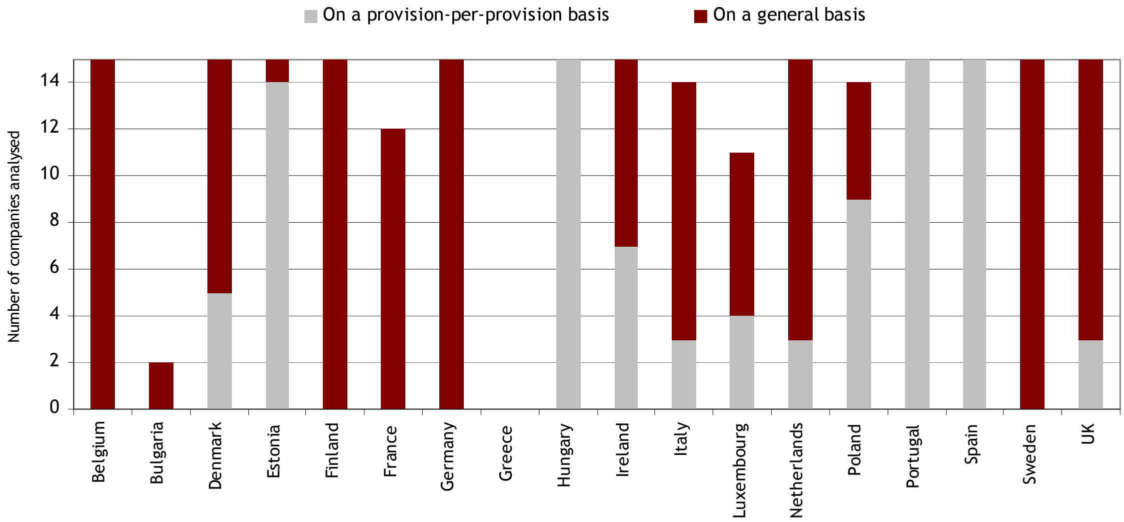
[193] The number of companies not disclosing comply-or-explain information comes down to a total of 6 companies out of 74. Five companies are domiciled in Greece, which does not have a reference corporate governance code, and one company is domiciled in Poland.

[194] The number of companies not disclosing comply-or-explain information comes down to a total of 31 companies out of 196. Most of these companies are situated in markets where either no code was established (Greece – 10 companies), where the information used for the purposes of this analysis did not yet refer to the latest version of the code (Bulgaria – 13 companies), or where companies did not yet have to disclose comply-or-explain information (France – 3 companies). The remainder are situated in Luxembourg (4 companies) and Italy (1 company).

codes, and 10 companies (five large-cap companies and five mid-cap companies) outline general explanations on the main differences between the corporate governance framework of the country where they are domiciled and the country of their secondary listing.

Figure II-2-2: **Level of detail on comply-or-explain information related to the reference corporate governance code in EU – per country**

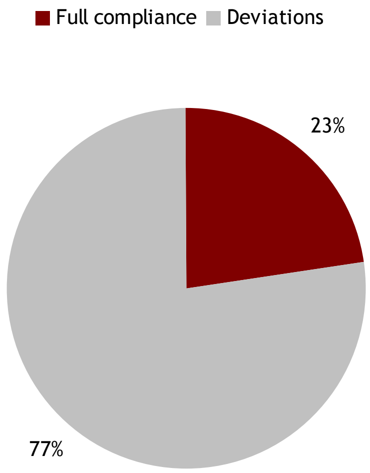
Number of companies disclosing comply-or-explain information:



39 percent of the 233 companies that publish comply-or-explain information disclose this information on a provision-per-provision basis. More than 70 percent of these companies are incorporated in one of the five markets where such disclosure is recommended by the code: Estonia, Hungary, Poland[195], Portugal, and Spain. As the publication of detailed information depends on local market practice, no notable differences have been observed at large-cap and mid-cap companies within individual Member States.

Figure II-2-3: **Level of compliance with the reference corporate governance code in EU – general**

Proportion of companies disclosing:



Of the companies providing comply-or-explain information, 180 companies (77 percent) indicate at least one deviation from the reference corporate governance code. The areas of deviation as well as the quality of the explanations provided by the companies deviating from the corporate governance reference code are examined in Chapter II-1.2.1 and Chapter II-1.2.2.

Of all companies indicating compliance with all provisions, only nine companies do this on a provision-per-provision basis. In five markets, each company has indicated at least one explanation of deviation: Belgium, Estonia, Hungary, Portugal and Spain. In the latter four of these markets, nearly all companies disclose comply-or-explain information on a provision-per-provision basis.

[195] Eight Polish companies in the sample refer to the 2005 corporate governance code, whereas the remaining seven companies refer to the 2007 corporate governance code. The 2007 Polish corporate governance code includes a recommendation to list comply-or-explain information on a provision-per-provision basis.

2.2.1 Areas of explanations for deviation provided by companies

This section involves identifying, presenting, and assessing the explanations provided by companies on their compliance with the reference corporate governance code. The explanations are divided into six main subject categories:

- board of directors (with issues related to board composition, election, practices, matters regarding committees in general, nomination committees, and executives),
- remuneration (with issues evolving around remuneration in general, remuneration committees, non-executive remuneration, executive remuneration, executive contracts, and share based remuneration),
- shareholder rights and duties,
- disclosure (general content of the annual report, language of the documents, information availability on the corporate website, timing of the publication, specific disclosure items on members of the (supervisory) board, disclosure of specific items at the general meeting),
- audit (with issues related to audit committees, composition of the audit committee, chairman of the audit committee, practices, responsibility towards the internal audit, and the external auditor), and
- other issues (with issues related to risk management, internal audit function, corporate secretary, and irregularity declaration procedures for employees).

Most of the explanations (55 out of 69) related to "other issues" are reported by Hungarian companies.

Figure II-2-4: **Total number of explanations on reference corporate governance codes in EU – per country**

	All companies disclosing comply-or-explain Information			Large-cap companies disclosing comply-or-explain Information			Mid-cap companies disclosing comply-or-explain Information		
Country	Number of companies	Total number of explanations	Average number of explanations	Number of companies	Total number of explanations	Average number of explanations	Number of companies	Total number of explanations	Average number of explanations
Belgium	15	42	3	5	17	3	10	25	3
Bulgaria	2	0	0	n/a	n/a	n/a	2	0	0
Denmark	15	54	4	5	30	6	10	24	2
Estonia	15	66	4	n/a	n/a	n/a	15	66	4
Finland	15	10	1	5	3	1	10	7	1
France	12	6	1	5	3	1	7	3	0
Germany	15	19	1	5	6	1	10	13	1
Greece	0	0	0	0	0	0	0	0	0
Hungary	15	560	37	2	47	24	13	513	39
Ireland	15	17	1	4	4	1	11	13	1
Italy	14	24	2	5	6	1	9	18	2
Luxembourg	11	12	1	3	1	0	8	11	1
Netherlands	15	65	4	5	28	6	10	37	4
Poland	14	39	3	4	9	2	10	30	3
Portugal	15	38	3	5	12	2	10	26	3
Spain	15	158	11	5	38	8	10	120	12
Sweden	15	18	1	5	8	2	10	10	1
UK	15	13	1	5	6	1	10	7	1
Total	233	1,141	5	68	218	3	165	923	6

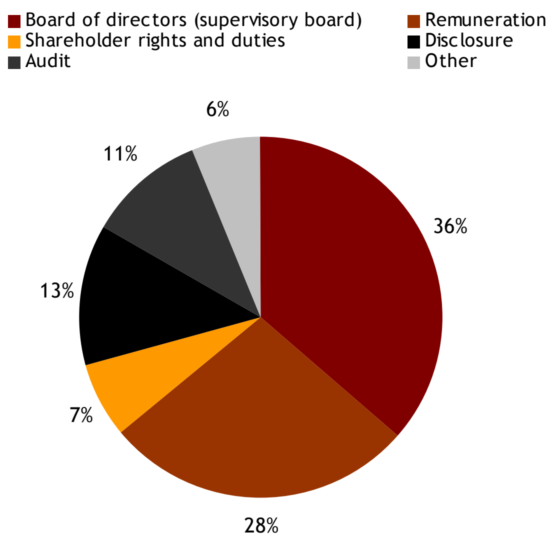
The companies analysed disclose a total of 1,141 explanations on their compliance with the applicable corporate governance code. This means an average of five explanations per company (for all companies disclosing comply-or-explain information). However, almost half of the explanations (560) are disclosed by Hungarian companies. If Hungary is excluded from the calculation, there is an average of approximately three explanations per company.

The markets with the highest number of explanations per company are Hungary, Spain, Estonia, Denmark, and the Netherlands. Three of these Member States require companies incorporated there to disclose comply-or-explain information on a provision-per-provision basis.

When analysing the differences between large-cap and mid-cap companies, large-cap companies in Denmark, France, the Netherlands, and Sweden have a higher average number of explanations than their mid-cap counterparts. On the other hand, an inverse relationship emerges for companies in Hungary, Poland, Portugal, and Spain. In this respect, the sample for France is not entirely representative, since companies were not obliged to disclose comply-or-explain information at the time materials used for this Study were published.

Figure II-2-5: **Breakdown of explanations per topic in EU - general**

Proportion of total number of explanations per reference corporate governance code:



At the EU level, 36 percent of all explanations concern the *board of directors*. 28 percent of all explanations concern *remuneration*. 7 percent of all explanations concern *shareholder rights and duties*. 13 percent of all explanations concern *disclosure*. 11 percent of all explanations concern *audit*. 6 percent of all explanations concern *other issues*.

In a few markets, the most prevalent topics of explanations differ quite significantly from the EU average. For example, all explanations provided by Finnish and French[196] companies are linked to board-related issues; half of the explanations in Portuguese companies concern remuneration, and over 60 percent of the explanations in Polish companies concern disclosure.

Noteworthy differences between large-cap companies and mid-cap companies can be found in the areas of board of directors and audit. 50 percent of all explanations from large-cap companies relate to the board of directors (nearly half of those explanations deal with board composition issues), whereas this area makes up 33 percent of all explanations identified in mid-cap companies. On the other hand, the area of audit – and more specifically audit committees – is more frequently the subject of explanations for mid-cap companies than for large-cap companies (14 percent of all explanations in mid-cap companies, versus 8 percent of all explanations in large-cap companies).

2.2.2 Classification of explanations

The quality of the explanations varies greatly from market to market, company to company, and provision to provision. For the purpose of this Study, we have classified the explanations into five categories: Invalid, General, Limited, Specific, and Transitional.

- Explanations of deviations which only indicate a deviation without further explanation were classified as “invalid”.
- Explanations of a general nature in which the company mostly indicates disagreement with the code provision without identifying a company specific situation, were classified as “general”.
- Explanations in which companies do not explain the reasons for deviating from the code, but where additional information was given such as an alternative procedure, were classified as “limited”.
- Explanations relating to a specific company situation were classified as “specific”.

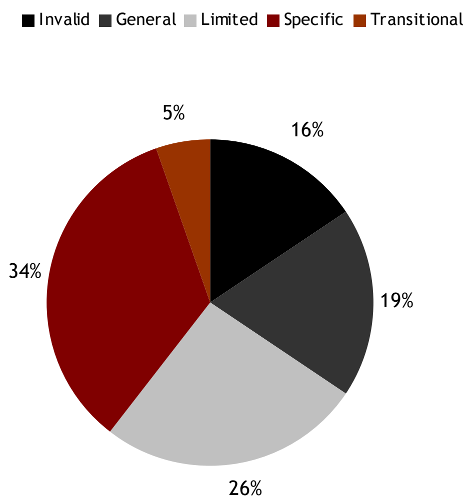
[196] It should be noted that at the time material used for this analysis was published, French companies were not obliged to disclose comply-or-explain information.

- Finally, if companies indicated that the code provision from which they currently deviate will be applied at a later stage, these explanations were classified as "transitional".

This rubric serves as a ranking of informative quality for explanations provided by the companies. It does not indicate whether or not the explanation provided by the company is acceptable for deviating from the code provision.

Figure II-2-6: **Classification of explanations in EU - general**

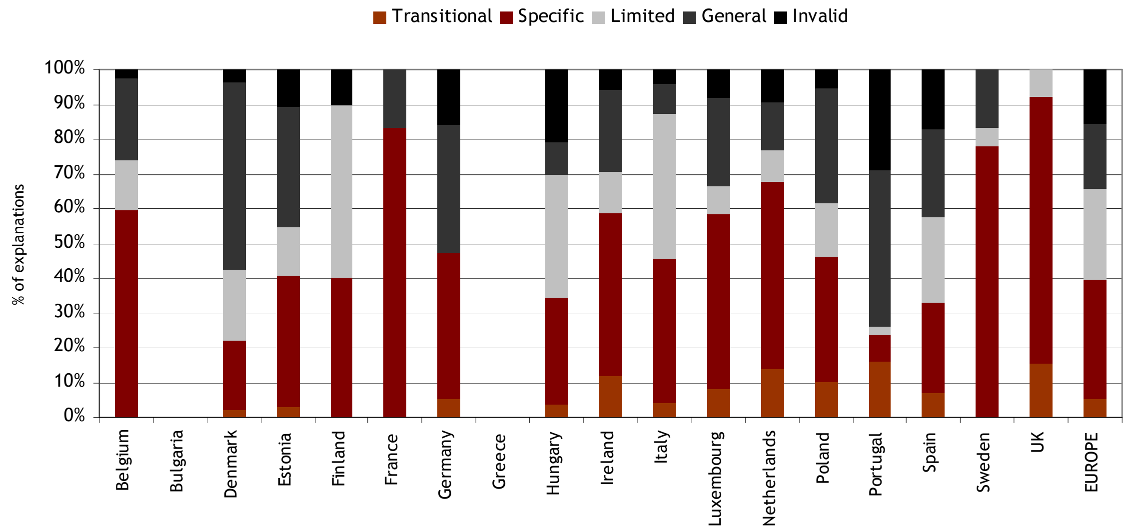
Proportion of total number of explanations per reference corporate governance code:



As shown opposite, at EU level, 34 percent of the explanations can be classified as specific, 5 percent as transitional, 26 percent as limited, 19 percent as general, and 16 percent as invalid.

Figure II-2-7: **Classification of explanations in EU - per country**

Proportion of total number of explanations per reference corporate governance code:



The above graph captures the 1,141 explanations on deviations disclosed by all companies analysed, providing a breakdown per country.

Companies which have the highest level of informative (specific and transitional) explanations proportionally can be found in the UK, France, Sweden, the Netherlands, and Belgium.

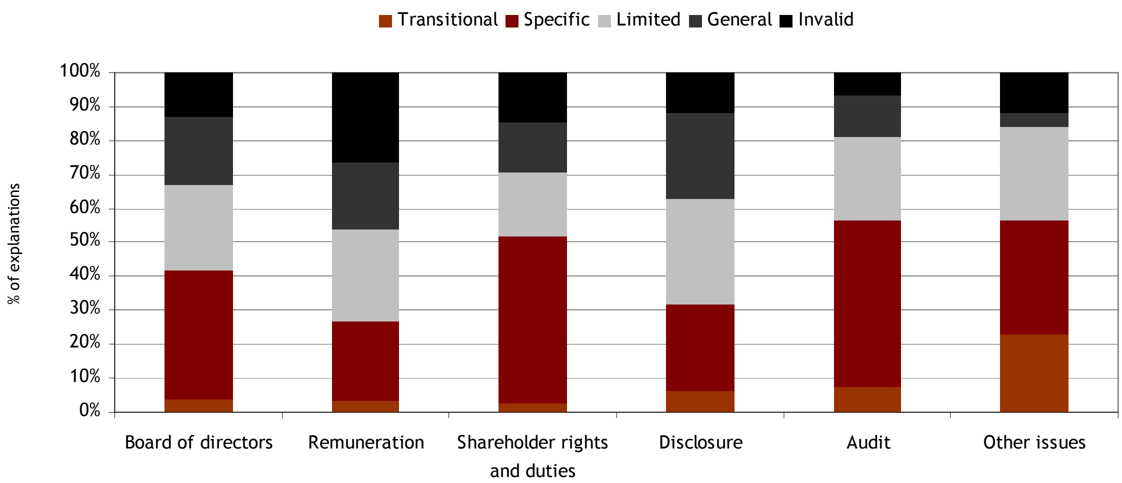
On the other hand, companies in Bulgaria and Greece are the only ones for which no explanations are identified. Companies in Denmark, Portugal, Spain, Hungary, and Finland are characterized by the least informative explanations. Three of these Member States require or advise companies to disclose comply-or-explain information on a provision-per-provision basis.

The quality of the explanations is determined by a number of factors. As mentioned in Chapter I of this Study, some countries have less prescriptive or less detailed corporate governance codes, which can influence the number of deviations or quality of the explanations. Also, as can be witnessed in Figure II.2.9, there seems to be a notable difference between companies disclosing explanations on a general basis compared to companies disclosing on a provision-per-provision basis. Companies disclosing explanations for deviations on a general basis have significantly higher informative value than companies disclosing explanations for deviations on a provision-per-provision basis. In some countries such as the UK, companies have long standing experience with corporate governance codes. Another determining factor can be found in the underlying ownership structures. Only two markets analysed have significantly less "important' shareholders, the Netherlands and the UK.

Differences between large-cap companies and mid-cap companies are small. For large-cap companies, a total of 42 percent of all explanations are classified as informative, whereas this figure is slightly lower for mid-cap companies (39 percent of all explanations). Mid-cap companies have a higher proportion of "transitional" explanations (6 percent of all explanations) when compared to large-cap companies (3 percent of all explanations).

Figure II-2-8: **Classification of explanations per topic in EU - general**

Proportion of total number of explanations per reference corporate governance code:



In figure II-2-8 above, the explanations are presented broken down by topic in order to see if there is a difference in the quality of explanations based on the subject. When looking at it from this perspective, it is evident that the least informative explanations have been identified in the category of remuneration, where a total of only 27 percent of explanations provide sufficient information to explain deviations from code provisions. The most informative explanations can be found for explanations on deviations from code provisions related to audit and other issues (56 percent of all explanations for each topic).

Figure II-2-9: **Overview of companies disclosing comply-or-explain information in general compared to companies disclosing on a provision-per-provision basis**[197]

Disclosure: companies disclosing comply-or-explain information						
	Companies disclosing comply-or-explain information		General information		Provision-per-provision information	
	number of companies	% of total sample	number of companies	% of companies	number of companies	% of companies
All companies	233	86%	141	61%	92	39%
Large-cap companies	68	92%	42	62%	26	38%
Mid-cap companies	165	84%	99	60%	66	40%

As mentioned above, of all companies disclosing comply-or-explain information, the majority of companies (141 companies out of 233 companies disclosing comply-or-explain information) analysed disclose general information on their level of compliance with their reference corporate governance code.

Full compliance: companies disclosing full compliance						
	Companies disclosing full compliance		General information		Provision-per-provision information	
	number of companies	% of total sample	number of companies	% of companies	number of companies	% of companies
All companies	52	22%	48	92%	4	8%
Large-cap companies	17	25%	16	94%	1	6%
Mid-cap companies	35	21%	32	91%	3	9%

A total of 52 companies disclose full compliance with their reference corporate governance code. Nearly all of these companies are part of the group of companies disclosing general information. Only 4 companies disclose full compliance on a provision-per-provision basis.

Average number of explanations for deviations				
	Companies disclosing comply-or-explain information		General information	Provision-per-provision information
	number of companies	% of total sample		
All companies	233	86%	2	10 (5)*
Large-cap companies	68	92%	2	6 (4)*
Mid-cap companies	165	84%	2	12 (5)*

* excluding Hungary

When making the distinction between companies disclosing comply-or-explain information on a general basis and companies disclosing information on a provision-per-provision basis, the latter group has on average a significantly higher number of explanations. Within this group of companies, the average number of explanations is also higher for mid-cap companies than for large-cap companies.

Informative quality of explanations of comply-or-explain information: average proportion of "specific" and "transitional" explanations				
	Companies disclosing comply-or-explain information		General information	Provision-per-provision information
	number of companies	% of total sample		
All companies	233	86%	53%	36%
Large-cap companies	68	92%	48%	40%
Mid-cap companies	165	84%	54%	35%

Looking at the informative value of explanations, companies disclosing general information tend to disclose explanations with a higher informative value than companies disclosing information on a provision-per-provision basis. This is very much the case for the group of mid-cap companies.

	Number of companies voluntarily disclosing on a provision-per-provision basis	Proportion of companies voluntarily disclosing on a provision-per-provision basis	Number of explanations provided by these companies	Proportion of explanations to total number of explanations
Denmark	5 out of 15	33%	12	22%
Ireland	7 out of 15	47%	7	41%
Italy	3 out of 14	21%	12	50%
Luxembourg	3 out of 11	27%	7	58%
Netherlands	3 out of 15	20%	19	29%
Poland	9 out of 14	64%	37	95%
UK	3 out of 15	20%	6	46%

[197] Out of total number of 1,141 explanations provided by companies on their reference corporate governance code, 560 explanations are disclosed by Hungarian companies.

Apart from companies domiciled in Estonia[198], Hungary, Portugal and Spain, another 33 companies in various Member States voluntarily disclose on a provision-per-provision basis. In most of these countries, notably in Italy, Luxembourg, the Netherlands, Poland, and the UK, companies disclosing on a provision-per-provision basis, disclose a higher number of deviations than their counterparts disclosing only general information. Therefore, regardless of whether they are obliged or recommended to disclose on a provision-per-provision basis, or whether they do this on a voluntary basis, companies disclosing on a provision-per-provision basis list an overall higher number of deviations.

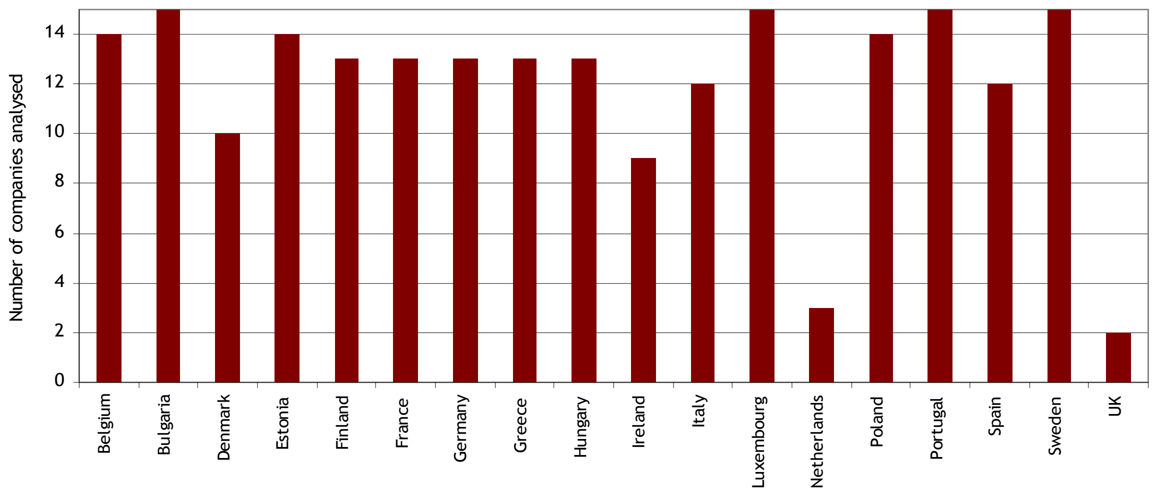
2.2.2.1 Explanations due to the existence of an important shareholder

80 percent (215 companies) of the companies in the total sample have at least one important shareholder[199].

Chapter I-1.4, pointed out that some important differences between national corporate governance codes may have their origins in the ownership structures of the various Member States. Listed companies are quite widely-held in Ireland and the UK, whereas ownership is very concentrated in Italy, Austria and Germany, and the Baltic Member States. France and the Netherlands, although not at the level of the United Kingdom, have quite low levels of ownership concentration, and the Nordic Member States as well as Belgium and Slovenia lie in an intermediate position[200].

Figure II-2-10: **Overview of important shareholders in EU and explanations based on the existence of important shareholders- per country**

Number of companies with an identified important shareholder:



Number of explanations of deviations linked to the existence of an important shareholder:

BE	BG	DK	EE	FI	FR	DE	GR	HU	IE	IT	LU	NL	PL	PT	ES	SE	UK
10	0	6	3	2	4	0	0	6	3	1	1	1	4	1	12	4	3

[198] In Estonia, 14 out of 15 companies disclose comply-or-explain information on a provision-per-provision basis.
[199] An important shareholder is defined as a shareholder in possession of at least 10 percent of a company's outstanding capital or that holds any other special right in the company not attributed to ordinary shareholders.
[200] More information can be found in Chapter I-1.4.

21 percent of the companies with an important shareholder explain at least one deviation from the corporate governance code based on the shareholder. In Spain, 10 out of 12 companies with an important shareholder do so; in Belgium 6 out of 14 do, and in Denmark 4 out of 10 do.

Important shareholders are, in a number of cases, granted special rights, which are normally granted to all shareholders. Generally, these rights are related to specific approval powers for nominating board members and other specific approval powers.

33 companies (12 percent of the total sample) where a specific shareholder or the State maintains a specific authority in terms of special rules involving selection or nomination procedures for the board of directors were identified. Roughly half of these companies have delegated these special powers to the State, either because the State is an important shareholder, or due to specific laws related to the company or the sector. The highest number of companies with such procedures are found in Belgium, where eight such occurrences were identified. In other markets where most companies had at least one important shareholder, such as Bulgaria, Finland, Spain, and Sweden, no such rules were identified.

Another 27 companies (10 percent of the total sample) were identified where a specific shareholder or the State has other types of privileges. These provisions relate mostly to special approval powers, whereby important decisions cannot be made without the specific shareholders' or the State's preliminary approval, or where they have a right to veto certain decisions. The second most common provision in this area relates to participation in the capital beyond a certain threshold or where such shareholders have agreed not to sell a minimum number of shares they hold for a specific timeframe. The last, and rather uncommon, special rule identified relates to preferential dividends to which these shareholders are entitled.

2.2.3 Country-specific observations

Figure II-2-11: **Classification of explanations per category in EU - per country**

Country	Number of explanations	Invalid	General	Limited	Specific	Transitional
Belgium	42	2%	24%	14%	60%	0%
Bulgaria	0	n/a	n/a	n/a	n/a	n/a
Denmark	54	4%	54%	20%	20%	2%
Estonia	66	11%	35%	14%	38%	3%
Finland	10	10%	0%	50%	40%	0%
France	6	0%	17%	0%	83%	0%
Germany	19	16%	37%	0%	42%	5%
Greece	0	n/a	n/a	n/a	n/a	n/a
Hungary	560	21%	9%	36%	31%	4%
Ireland	17	6%	24%	12%	47%	12%
Italy	24	4%	8%	42%	42%	4%
Luxembourg	12	8%	25%	8%	50%	8%
Netherlands	65	9%	14%	9%	54%	14%
Poland	39	5%	33%	15%	36%	10%
Portugal	38	29%	45%	3%	8%	16%
Spain	158	17%	25%	25%	26%	7%
Sweden	18	0%	17%	6%	78%	0%
UK	13	0%	0%	8%	77%	15%
Total	1,141	16%	19%	26%	34%	5%

Below is a presentation of individual country information on the explanations provided by companies. An overview is provided on the type of disclosure, the number of explanations, the classification of the explanations following the methodology outlined above, the main rationale of the explanations, the categories of explanations as well as an overview of individual provisions from which companies most typically deviate. Two countries have been excluded from this overview: Greece and Bulgaria. As stated above, Greek companies do not refer to any corporate governance code and therefore do not disclose comply or explain information. As for Bulgaria, the obligation to report on the national corporate governance code entered into force in 2008. Only two Bulgarian companies have disclosed a general reference to the corporate governance code without providing further information.

2.2.3.1 Belgium

In Belgium, all companies sampled disclose comply-or-explain information. All companies in the sample disclose comply-or-explain information on a general basis. A total of 42 explanations were identified for all companies in the sample. This means an average of three explanations per company with no significant difference between large companies and mid-cap companies.

Proportionally, the largest group of explanations is the group of “specific” explanations (60 percent of explanations qualified as “specific”). This observation is the case for both large-cap companies (65 percent of explanations qualified as “specific”) and for mid-cap companies (56 percent of explanations qualified as “specific”). However, a difference in informative quality between both groups can be observed: the only explanations classified as “invalid” are found in mid-cap companies, and mid-cap companies have fewer “specific” explanations.

The main rationale for “specific” explanations disclosed by companies is based on shareholder structure, company activities, company history, legal obligations, board size, and set-up before introduction of the code. No transitional explanations were found.

Generally, most explanations revolve around the “board of directors” category (57 percent of all explanations), followed by the “remuneration” category (21 percent of all explanations).

More specifically, explanations for deviations are provided for 18 different code provisions, and the most common provisions where companies deviate are:

- composition of committees (5 companies),
- threshold for the possibility to put items on the agenda (5 companies), and
- maximum term for board members (3 companies).

2.2.3.2 Denmark

In Denmark, all companies sampled disclose comply-or-explain information. Most companies in the sample disclose comply-or-explain information on a general basis (10 companies out of 15 disclose general information). A total of 54 explanations are identified for all companies in the sample. This figure amounts to an average of four explanations per company with a significant difference between large-cap companies (average of six explanations per company) and mid-cap companies (average of two explanations per company).

Proportionally, the largest group of explanations is the group of “general” explanations (54 percent of explanations qualified as “general”). This is the case for both large-cap companies (63 percent of explanations qualified as “specific”) and for mid-cap companies (42 percent of explanations qualified as “specific”). However, a significant difference in informative quality between both groups can be observed: the only explanations classified as “invalid” were found in large-cap companies, and mid-cap companies have fewer “general” explanations.

The main rationale for specific explanations disclosed by companies is based on shareholder structure, company activities, and legal obligations. Overall, 2 percent of the explanations were classified as transitional; all are identified in mid-cap companies.

Generally, most explanations revolve around the “board of directors” category (56 percent of all explanations), followed by the “remuneration” category (22 percent of all explanations).

More specifically, explanations for deviations are provided on 23 different code provisions, and the most common provisions where companies deviate are:

- limit on number of outside positions for supervisory board members (6 companies),
- annual reelections (6 companies),
- evaluation of supervisory board (6 companies), and
- disclosure of individual information on remuneration (6 companies).

2.2.3.3 Estonia

In Estonia, all companies sampled disclose comply-or-explain information. Nearly all companies in the sample disclose comply-or-explain information on a provision-per-provision basis (14 companies out of 15). A total of 66 explanations are identified for all companies in the sample. This figure amounts to an average of four explanations per company. No companies in Estonia are classified as large-cap companies.

Proportionally, the largest group of explanations is the group of “specific” explanations (38 percent of explanations qualified as “specific”). “General” explanations make up 34 percent of all explanations.

The main rationale for “specific” explanations disclosed by companies is based on shareholder structure, history of the company, materiality assessment, practical reasons, interest of the shareholder, and costs related to executing the code provision.

Generally, most explanations revolve around the “remuneration” category (32 percent of all explanations), followed by the “board of directors” category (29 percent of all explanations).

More specifically, explanations for deviations are provided on 16 different code provisions, and the most common provisions where companies deviate are:

- disclosure of individual information on remuneration (13 companies),
- disclosure of the dates and places of meetings with analysts and presentations and press conferences organised for analysts, investors, or institutional investors on its website (9 companies), and
- participation of board members and auditor at the general meeting (8 companies).

2.2.3.4 Finland

In Finland, all companies sampled disclose comply-or-explain information. All companies in the sample disclose comply-or-explain information on a general basis. A total of 10 explanations are identified for all companies in the sample. This figure amounts to an average of less than one explanation per company with no significant difference between large-cap companies and mid-cap companies.

In total, 5 out of 10 explanations are classified as “limited.” 4 of the 10 explanations for deviations found in Finland have been classified as “specific.” These explanations largely state shareholder structure as the primary reason for deviation.

All explanations identified revolve around the “board of directors” category.

Explanations of deviations are provided for four code provisions. The only deviation reported by several companies concerns:

- composition of the nomination committee (6 companies).

2.2.3.5 France

In France, the information used for the companies sampled was published during a period where the mandatory[201] comply-or-explain approach had not yet entered into force. Therefore, the results in terms of number of deviations obtained from this analysis cannot be considered representative.

All large-cap companies disclose comply-or-explain information, whereas 7 out of 10 mid-cap companies disclose such information. A total of six explanations are identified for all companies.

All explanations identified revolve around the “board of directors” category.

In total, 5 of the 6 explanations for deviations found are “specific” ones stating shareholder structure and specific binding legal rules as reasons for deviation. All explanations found revolve around the “board of directors” category.

More specifically, explanations relate to:

- composition of the committees (2 companies) and
- application of the independence definition (2 companies).

2.2.3.6 Germany

In Germany, all companies sampled disclose comply-or-explain information. All companies in the sample disclose comply-or-explain information on a general basis. A total of 19 explanations are identified for all companies in the sample. This figure amounts to an average of one explanation per company and no significant difference between large-cap companies and mid-cap companies.

Proportionally, the largest group of explanations is the group of “specific” explanations (42 percent of explanations qualified as “specific”). This is the case for both large-cap companies (50 percent of explanations qualified as “specific”) and for mid-cap companies (38 percent of explanations qualified as “specific”). However, a difference in informative quality between both groups can be observed: the only explanations classified as “invalid” are found in mid-cap companies (23 percent of explanations provided by mid-cap companies are classified as “invalid”), and mid-cap companies have fewer “specific” explanations. 8 percent of explanations provided by mid-cap companies are classified as “transitional”.

The main rationale for “specific” explanations disclosed by companies is based on specific company agreements, company practice which has proven to be valuable in the past, or the size of the company.

Generally, most explanations revolve around the “board of directors” category (53 percent of all explanations), followed by the “remuneration” category (37 percent of all explanations).

Explanations of deviations are provided for 14 code provisions. There is only one noteworthy code provision from which several companies deviate:

- composition of the nomination committee (4 companies).

[201] See footnote 18.

2.2.3.7 Hungary

In Hungary, all companies sampled disclose comply-or-explain information. All companies in the sample disclose comply-or-explain information on a provision-per-provision basis. A total of 560 explanations are identified for all companies in the sample. This figures amount to an average of 37 explanations per company, with a significant difference between large-cap companies (average of 24 explanations per company) and mid-cap companies (average of 39 explanations per company)[202].

Proportionally, the largest group of explanations is the group of “limited” explanations (36 percent of explanations qualified as “limited”). This is the case for both large-cap companies (55 percent of explanations qualified as “specific”) and for mid-cap companies (34 percent of explanations qualified as “specific”). These explanations offer some information, but either the companies merely list an alternative procedure or practice without further explanation of why the company does not follow the recommended practice or the companies give an answer which is not entirely clear.

One of the main characteristics of the explanations in Hungary is repetition of explanations. Also, a large proportion of explanations in Hungary are incomplete and unclear. Of all explanations classified as “specific,” most of them are for reasons of non-applicability. In most markets, such situations would not be listed as a deviation but would be marked as not applicable; for instance, Hungarian companies might answer a code provision recommending good practice on share incentives by saying that there are no such plans in the company, and list this as a deviation. If these types of explanations are not taken into account, there are few informative explanations remaining.

Generally, most explanations revolve around the “remuneration” category (33 percent of all explanations), followed by the “board of directors” category (21 percent of all explanations).

More specifically, explanations are provided for 78 different code provisions, and the most common provisions where companies deviate concern:

- setting up a nominating committee (13 companies),
- disclosure of individual information on the remuneration of the supervisory board, managing body, and executive management (13 companies), and
- having internal audit function set up based on an authorisation of the audit committee (13 companies).

2.2.3.8 Ireland

In Ireland, all companies sampled disclose comply-or-explain information. The majority of companies in the sample disclose comply-or-explain information on a general basis (8 companies out of 15 disclose general information). A total of 17 explanations are identified for all companies. This figure amounts to an average of one explanation per company with no significant difference between large-cap companies and mid-cap companies[203].

Proportionally, the largest group of explanations is the group of “specific” explanations (47 percent of explanations qualified as “specific”). This is the case for both large-cap companies (75 percent of explanations qualified as “specific”) and for mid-cap companies (38 percent of explanations qualified as “specific”). However, a difference in informative quality between both groups can be observed: the only explanations classified as “invalid” are found in mid-cap companies, and mid-cap companies have far less “specific” explanations. 15 percent of explanations provided by mid-cap companies are classified as “transitional”.

[202] In Hungary, only two companies are classified as large-cap companies. The remaining companies (13 companies) are classified as mid-cap companies.
[203] In Ireland, only four companies could be classified as large-cap companies. The remainder of companies (11 companies) are classified as mid-cap companies.

The main rationale for "specific" explanations disclosed by companies is based on a materiality assessment of board members (in relation to independence definition), a specific right of the government, or shareholder structure.

Generally, most explanations revolve around the "board of directors" category (71 percent of all explanations), followed by the "remuneration" category (18 percent of all explanations).

More specifically, explanations for deviations are provided on 11 different code provisions, and the most common provisions where companies deviate are:

- independence definition (5 companies) and
- director term of office (2 companies).

2.2.3.9 Italy

In Italy, nearly all companies sampled (14 out of 15 companies) disclose comply-or-explain information. Most companies in the sample disclose comply-or-explain information on a general basis (11 companies out of 14 disclose general information). A total of 24 explanations are identified for all companies. This figure amounts to an average of two explanations per company with a slight difference between large-cap companies (average of one explanation per company) and mid-cap companies (average of two explanations per company).

There are two main groups of explanations observed in our sample of Italian companies: both "specific" explanations and "limited" explanations make up 42 percent of all explanations each. A notable difference in informative quality between large-cap companies and mid-cap companies can be observed. For large-cap companies, half of the explanations disclosed are classified as "specific," and an additional 17 percent of explanations are qualified as "transitional." For mid-cap companies, however, half of the explanations disclosed are classified as "limited." Only 38 percent of the explanations are classified as "specific," and no "transitional" explanations have been identified.

The main rationale for "specific" explanations disclosed by companies is based on the specific authority of the chairman, minority right to nominate directors, company merger, independence qualification, and shareholder structure.

Generally, most explanations revolve around the "board of directors" category (50 percent of all explanations), followed by the "remuneration" category (17 percent of all explanations).

More specifically, explanations of deviations are provided on 11 different code provisions, and the most common provisions where companies deviate are:

- procedures of the general meeting to be voted on by shareholders (4 companies) and
- definition of independence (3 companies).

2.2.3.10 Luxembourg

In Luxembourg, most companies sampled (11 out of 15 companies) disclose comply-or-explain information. Most companies disclose in the sample comply-or-explain information on a general basis (7 companies out of 11 disclose general information). A total of 12 explanations are identified for all companies in the sample. This figure amounts to an average of one explanation per company and no significant difference between large-cap companies and mid-cap companies[204].

[204] In Luxembourg, only three companies are classified as large-cap companies. The remainder of companies (12 companies) are classified as mid-cap companies.

Six of 12 explanations are qualified as “specific.” The main rationale for “specific” explanations disclosed by companies is based on company size, a specific company situation, specific company activities, or ownership structure.

Generally, most explanations revolve around the “board of directors” category (58 percent of all explanations), followed by the “remuneration” category (17 percent of all explanations).

More specifically, explanations are provided for a total of eight code provisions. Deviations reported by more than one company deal with:

- independence definition and
- setting up of nomination committee.

2.2.3.11 Netherlands

In the Netherlands, all companies sampled disclose comply-or-explain information. Most companies in the sample disclose comply-or-explain information on a general basis (12 companies out of 15 disclose general information). A total of 65 explanations are identified for all companies in the sample. This figure amounts to an average of four explanations per company with a difference between large-cap companies (average of six explanations per company) and mid-cap companies (average of four explanations per company).

Proportionally, the largest group of explanations is the group of “specific” explanations (54 percent of explanations qualified as “specific”). This observation is the case for both large-cap companies (54 percent of explanations qualified as “specific”) and for mid-cap companies (54 percent of explanations qualified as “specific”). Additionally, 11 percent of explanations for large-cap companies are classified as “transitional,” whereas this percentage is slightly higher for mid-cap companies (16 percent).

The main rationale for specific explanations disclosed by companies is based on a situation that existed before the code came into force, specificity of company activities, specificity of company situation (size of board, dual listed), or legal references.

Generally, most explanations revolve around the “board of directors” category (45 percent of all explanations), followed by the “remuneration” category (32 percent of all explanations).

More specifically, explanations for deviations are provided on 35 different code provisions, and the most common provisions where companies deviate are:

- maximum severance payment (8 companies),
- maximum duration of appointment for executives (6 companies),
- no more than one non-independent board member on the supervisory board (5 companies), and
- performance criteria for stock options (5 companies).

2.2.3.12 Poland

In Poland, nearly all sampled companies (14 companies out of 15) disclose comply-or-explain information. Most companies in the sample disclose comply-or-explain information on a provision-per-provision basis (9 companies out of 14 disclose information on a provision-per-provision basis). Eight out of 15 Polish companies sampled refer to the 2005 version of the corporate governance code, whereas the remainder refers to the 2007 version. Most companies sampled that refer to the

2007 corporate governance code do so on a provision-per-provision basis. A total of 39 explanations are identified for all companies in the sample. This amounts to an average of three explanations per company with a slight difference between large-cap companies (average of two explanations per company) and mid-cap companies (average of three explanations per company).

Proportionally, the largest group of explanations is the group of “specific” explanations (36 percent of explanations qualified as “specific”), closely followed by “general” explanations (33 percent of all explanations). A significant difference in informative quality between large-cap companies and mid-cap companies can be observed: the largest proportion of explanations in large-cap companies are classified as “specific” (44 percent of all explanations), whereas the largest proportion for mid-cap companies is classified as “general” (37 percent of all explanations).

The main rationale for “specific” explanations disclosed by companies is based on the company’s ownership structure, a specific company situation (size, group rules), or legal references.

Generally, most explanations revolve around the “board of directors” category (46 percent of all explanations), followed by the “disclosure” category (28 percent of all explanations).

More specifically, explanations for deviations are provided on 16 different code provisions, and the most common provisions where companies deviate are:

- provisions on proportion of independence on the board of directors (7 companies),
- information to be published on the website (6 companies), and
- overall functions of the committees (4 companies).

2.2.3.13 Portugal

In Portugal, all sampled companies disclose comply-or-explain information. All companies in the sample disclose comply-or-explain information on a provision-per-provision basis. A total of 38 explanations are identified for all companies in the sample. This amounts to an average of 3 explanations per company with a slight difference between large-cap companies (average of two explanations per company) and mid-cap companies (average of three explanations per company).

The largest group of explanations is the group of “general” explanations (45 percent of explanations qualified as “general”). This is both the case for large-cap companies (58 percent of explanations qualified as “general”) and for mid-cap companies (38 percent of explanations qualified as “general”). However a difference in informative quality between both groups can be observed: the explanations classified as “invalid” are significantly higher for mid-cap companies (35 percent) whereas the “invalid” explanations for large-cap companies make up 17 percent of all explanations.

Generally, most explanations revolve around the “remuneration” category (50 percent of all explanations), followed by the “board of directors” category (18 percent of all explanations) and the “shareholder rights” category (18 percent of all explanations).

More specifically, explanations for deviations are provided on nine different code provisions, and the most common provisions where companies deviate are:

- individual disclosure of remuneration (14 companies),
- proportion of independence on the board (6 companies), and
- whistle blowing policy (5 companies).

2.2.3.14 Spain

In Spain, all sampled companies disclose comply-or-explain information. All companies in the sample disclose comply-or-explain information on a provision-per-provision basis. A total of 158 explanations are identified for all companies in the sample. This amounts to an average of 11 explanations per company with a significant difference between large-cap companies (average of eight explanations per company) and mid-cap companies (average of 12 explanations per company).

Explanations are almost evenly divided between "invalid" explanations (17 percent of all explanations), "general" explanations (25 percent of all explanations), "limited" explanations (25 percent of all explanations), and "specific" explanations (26 percent of all explanations). This overall picture is nearly the same when examining the differences between large-cap companies and mid-cap companies, although it can be stated that large-cap companies have slightly more informative explanations (proportion of "specific" explanations make up 32 percent compared to 24 percent for mid-cap companies).

The main rationale for "specific" explanations disclosed by companies is based on the company's ownership structure, company activities, proportion of independence as counterbalance, a situation which is not applicable, specific situation of the chairman or legal reference.

Generally, most explanations revolve around the "board of directors" category (46 percent of all explanations), followed by the "disclosure" category (28 percent of all explanations).

More specifically, explanations for deviations are provided on 46 different code provisions, and the most common provisions where companies deviate are:

- submitting a report on the directors' remuneration policy to the advisory vote of the general meeting, as a separate point on the agenda (12 companies),
- disclosure of individual information on remuneration (10 companies),
- proportion of board independence (9 companies) and
- rules on the maximum number of directorships board members may hold (9 companies).

2.2.3.15 Sweden

In Sweden, all companies sampled disclose comply-or-explain information. All companies in the sample disclose comply-or-explain information on a general basis. A total of 18 explanations are identified for all companies in the sample. This amounts to an average of one explanation per company with a slight difference between large-cap companies (average of two explanations) and mid-cap companies (average of one explanation).

The largest group of explanations is the group of "specific" explanations (78 percent of explanations qualified as "specific"). This is both the case for large-cap companies (75 percent of explanations qualified as "specific") and for mid-cap companies (80 percent of explanations qualified as specific).

The main rationale for "specific" explanations disclosed by companies is based on independence materiality assessments performed for directors, ownership structure and specific situation of the chairman.

Generally, most explanations revolve around the "board of directors" category (50 percent of all explanations), followed by the "disclosure" category (22 percent of all explanations).

More specifically, explanations for deviations are provided on seven different code provisions, and the most common provisions where companies deviate:

- proportion of independence on the board of directors (4 companies),
- composition of the nomination committee (4 companies), and
- setup and composition of the remuneration committee (4 companies).

2.2.3.16 UK

In the UK, all companies sampled disclose comply-or-explain information. Most companies in the sample disclose comply-or-explain information on a general basis (12 companies out of 15 disclose general information). A total of 13 explanations are identified for all companies in the sample. This amounts to an average of one explanation per company with no significant differences between large-cap companies and mid-cap companies.

The largest group of explanations is the group of "specific" explanations (77 percent of explanations qualified as "specific"). This is both the case for large-cap companies (83 percent of explanations qualified as "specific") and for mid-cap companies (71 percent of explanations qualified as specific). Additionally, the remainder of explanations provided by mid-cap companies are classified as "transitional."

The main rationale for "specific" explanations disclosed by companies is based on independence materiality assessments performed for directors, ownership structure and existing contracts.

More specifically, explanations for deviations are provided on nine different code provisions, and the most common provisions where companies deviate are:

- independence definition (4 companies) and
- setup and composition of the audit committee (2 companies).

3 BOARD OF DIRECTORS (SUPERVISORY BOARD)

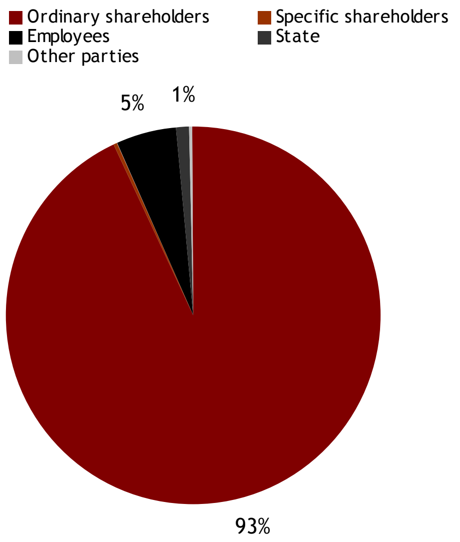
This section takes a closer look at director elections and director independence. More specifically, we will investigate to what extent shareholders have an influence on the composition of the boards, including whether they can only vote entire lists of directors or if proposals for single board members are submitted to a vote at the general meeting.

As discussed in Chapter I-2.1, in February 2005, the Commission adopted a Recommendation to clarify the role of boards of directors and committees, aiming at eliminating and preventing conflicts of interest within boards of directors[205]. Member States were invited to take the necessary measures to promote the application of the Commission Recommendation by June 30th, 2006, either through legislation or through best practice rules.

Within the EU, there are market specific differences concerning the exact powers, duties, and responsibilities of the board of directors. Some of the differences stem from the board structures. Companies with a dual board structure have a supervisory board of non-executive directors and a management board with executive directors and companies with a unitary board structure usually have both executive and non-executive directors serving on the board. Also, a number of markets have legal rules that foresee employees' right to elect representatives to the board.

Figure II-3-1: **Election of board members in EU - general**

Average proportion of board members elected by:



At the EU level, an average of 93 percent of the members of the board of directors (or supervisory board) have been elected by shareholders, and 5 percent have been elected by employees. The proportion of board members elected by specific shareholders, the State, and other parties was found to be negligible. The three markets with the highest proportion of board members elected by employees were Germany (41 percent of all board members), Denmark (28 percent of all board members), and Sweden (15 percent of all board members). In these three Member States, there are legal rules that foresee employees' right to elect their own representatives to the board without the general meeting having any control on that decision as soon as the company reaches a certain size in terms of employee headcount.

The proportion of board members elected by other participants was found to be quite minimal, although in each of one Greek and one Italian company, more than 50 percent of the board had been elected by the State. In the Greek company, the articles of association stipulate that six of the 11 members of the board of directors be elected by the general assembly of the majority shareholder, which, in this case is the Greek state, and in which the minority shareholders are not entitled to participate. In the Italian company, the articles of associations state that, pursuant to the Italian Civil Code, the Municipality of Rome has the right to directly appoint, at the meeting, a number of directors proportional to its ownership, rounded upwards in case of fractions. Thus, in both these cases the state elects board members in its position as a majority shareholder and is appointing directors proportionally to its holdings.

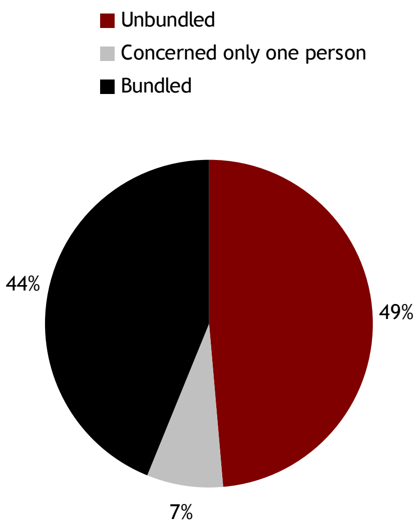
[205] Commission Recommendation on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, 2005/162/EC, dated February 15th, 2005; available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2005:052:0051:0063:EN:PDF.

3.1 Director elections

While it is still far from being widely accepted as practice, many markets have displayed a tendency to abandon bundled director elections in favour of individual director elections. Many shareholders view it as vital to be able to express an opinion about individual directors through a vote at the shareholders meeting, instead of being limited to voting on the board as a whole.

Figure II-3-2: **Breakdown of board elections in EU - general**

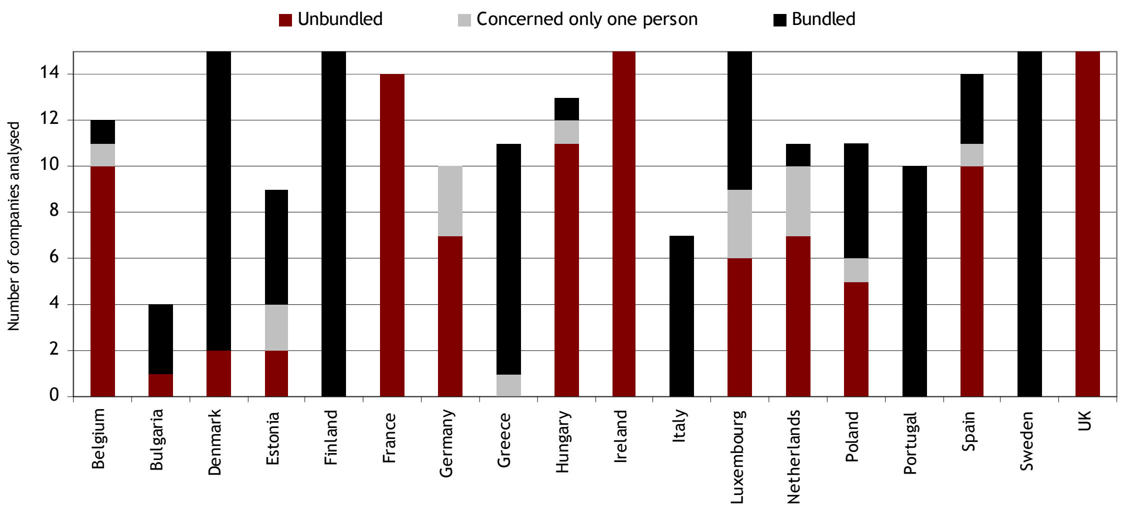
Proportion of companies in 2008 where elections were:



216 of the 270 companies in the sample elected at least one director in 2008. In 49 percent of these cases, the elections were unbundled. In 44 percent of the cases elections were bundled and in 7 percent of the cases only one board member was proposed for election.

Figure II-3-3: **Breakdown of board elections in EU - per country**

Number of companies in 2008 where elections were:



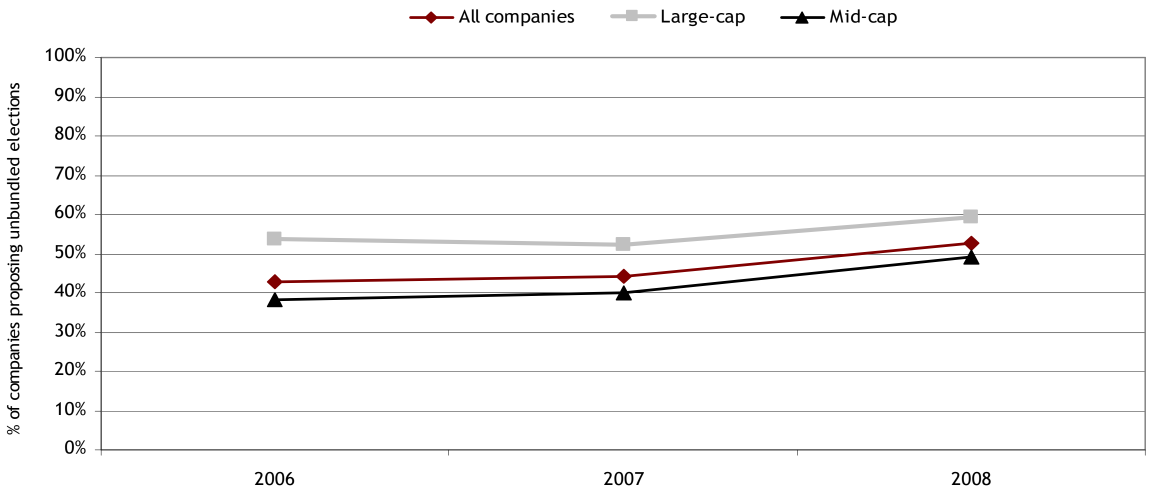
In Finland, Greece, Italy, Portugal, and Sweden, all elections of more than one director were proposed as a bundled item on the agenda. On the other hand, in France, Germany, Ireland, and the UK, all elections of more than one director were unbundled.

It is possible to find explanations to market practice in some of these cases: Italy uses the “Voto di lista” mechanism, which allows shareholders who represent a certain percentage of capital, a percentage prescribed in the company's bylaws, to submit a list of candidates as director nominees. Each shareholder may only cast one vote for director elections; they can either vote in favour of one slate or abstain. A vote “against” is considered against all slates. This mechanism represents a bundled resolution, because shareholders have to vote for one slate of candidates (and not for each director individually).

In Finland and Sweden, any shareholder present at the AGM may ask the chairman of the meeting to conduct elections individually. As a plurality voting system[206] is applied, however, votes against have no impact on the likelihood of a director being elected, as long as there is no alternative candidate.

Figure II-3-4: **Evolution of unbundled elections in EU – per company type**

Proportion of companies proposing elections to the shareholders:



While unbundled director elections cannot yet be considered European market practice, the proportion of unbundled elections overall has risen by about 10 percent from 2006 to 2008. As shown in the graph above, a majority of the companies with elections of more than one director proposed unbundled elections for the first time in 2008[207]. Thus, the trend is towards individual director elections in the 18 Member States included in this Study.

The rise of the mid-cap companies, in this instance, is more prevalent than is the case for large-cap companies. Whereas large-cap companies three years ago had a level of 54 percent of unbundled director elections, the rate has risen about 5 percent. As for mid-cap companies, three years ago, the level of unbundled elections amounted to 38 percent; it has reached 49 percent in 2008.

[206] In a plurality voting system, there is no requirement to gain an *absolute majority* of votes, but it is enough to gain more votes than any competing candidate(s) to be elected. In other words, if there is no competing candidate, a director could be (re)elected with only one (1) vote in favour and 1 million votes against/abstaining.

[207] The proportions are based on the number of companies proposing elections between 2006 and 2008: in 2006, within the total sample of companies analysed, 196 board elections were proposed to shareholders (19 concerning one person), in 2007 companies proposed 213 board elections (25 concerning one person), and 216 board elections in 2008 (16 concerning one person). The graph does not take into account elections where only one person was running for election.

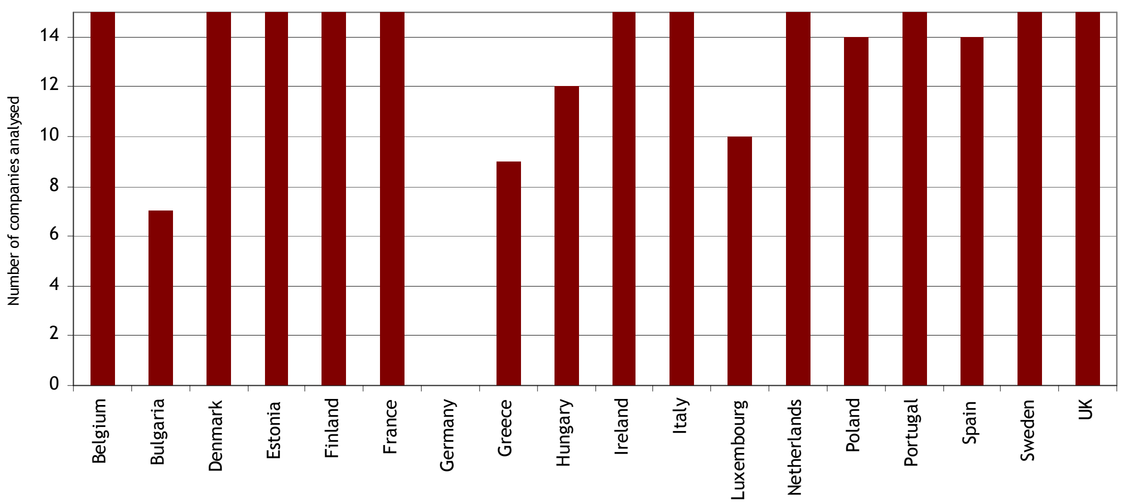
3.2 Director independence

As stated in the 2005 Commission Recommendation on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, the presence of independent representatives on the board, capable of challenging the decisions of management, is widely considered a means of protecting the interests of shareholders and other stakeholders[208].

In most of the Member States, the topic of independence is a soft law topic that is mainly dealt with in corporate governance codes. Indeed, as the Commission Recommendation to a large extent left Member States to define their own definition of independence, the various markets have quite diverse definitions[209].

Figure II-3-5: **Reference to definition of independence in EU – per country**

Number of companies referring to a definition of independence:



A large majority (231 companies, 86 percent) of the companies in the sample refer to a definition of independence. For large-caps, 89 percent refer to a definition of independence and 84 percent of the mid-cap companies do. The main outlier is Germany, where not a single company refers to such definition. The German corporate governance code is the only EU code that does not contain any independence definition. In most markets, 14 or 15 (all) companies refer to an independence definition.

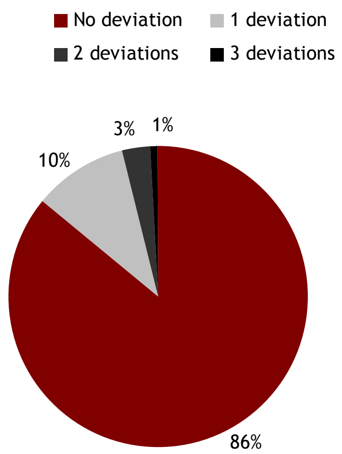
The majority (164 companies out of 270) of the companies refer to the independence definition in the national code of corporate governance or to the code of corporate governance of the country where they are domiciled. 67 companies (29 percent of companies disclosing or referring to a definition of independence) refer to a legal definition of independence. This is prevalent in Belgium, Italy, and Portugal. 21 companies (9 percent of companies disclosing or referring to a definition of independence) have their own definition of independence without referring to any other external source of independence definition.

As stated in Chapter II-1.2.1, at the EU level, the board of directors is the most common area of deviation from among the sample companies. Many of these deviations do indeed concern independence.

208 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2005:052:0051:0063:EN:PDF.
209 For more on this issue, see Chapter I-3.1.2.

Figure II-3-6: **Deviations of definition of independence in EU - general**

Proportion of companies referring to a definition of independence disclosing:

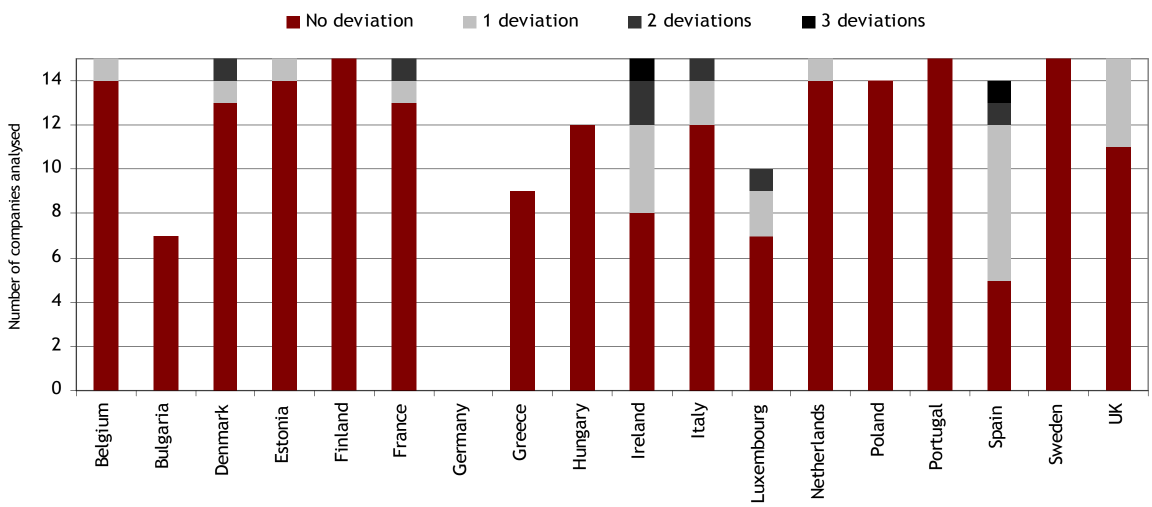


Of the 231 companies that refer to a definition of independence, 14 percent disclose one or more deviations from the independence defined by the code.

In total, these companies disclose 44 deviations from the definition of independence they refer to. Half of these deviations are linked to tenure. The second most common deviation is linked to shareholder relations (18 percent), followed by business relations (9 percent).

Figure II-3-7: **Deviations of definition of independence in EU – per country**

Number of companies referring to a definition of independence disclosing:



As shown in figure II-3-7, on a market-by-market level, deviation from the corporate governance code's definition of independence seems particularly common in Spanish and Irish companies. In both markets, deviation due to not considering a director non-independent due to tenure are the most common. In Ireland, two companies also consider at least one director independent even though s/he is a controlling shareholder or a director of such a shareholder. In seven markets (Bulgaria, Finland, Greece, Hungary, Poland, Portugal, and Sweden) not a single company has reported a deviation from the independence definition.

The difference between large-cap and mid-cap companies regarding the number of deviations from the independence definition is quite significant. 21 percent of the large-cap companies disclose at least one deviation whereas this proportion is 11 percent for mid-cap companies.

4 AUDIT COMMITTEES

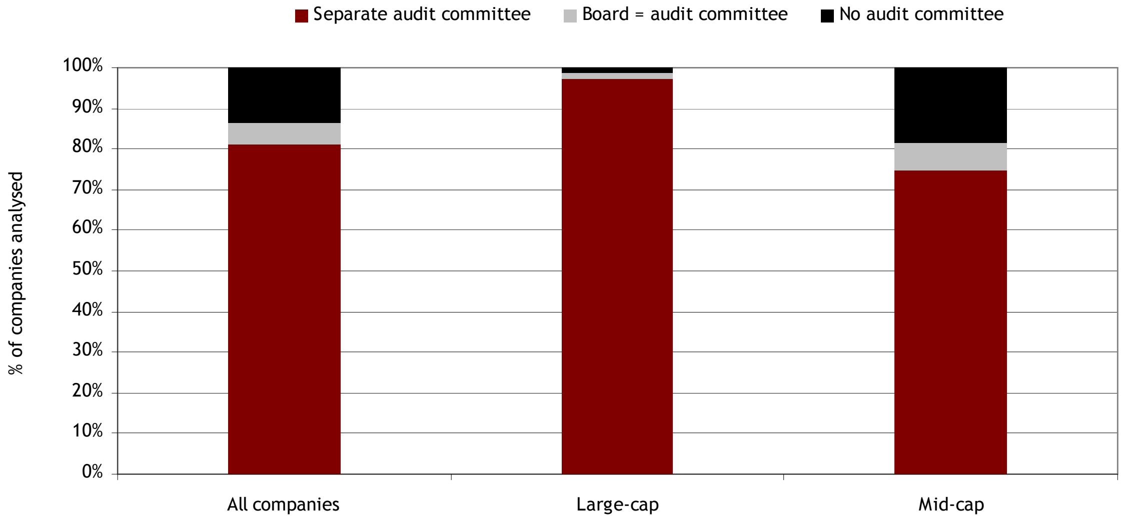
This section takes a closer look at audit committees. Beyond looking at the existence and composition of audit committees in the sample, the functioning of such committees is further scrutinized, as well as disclosure of audit-related and non-audit-related fees.

The establishment of an audit committee has been mandatory for public companies since the EU Directive on Statutory Audit 2006/43/EC was introduced. Audit committees shall comprise, strictly, non-executive board members, and at least one member of the audit committee shall be independent and have competence in accounting and/or auditing. If the company meets certain criteria, Member States may permit the functions assigned to the audit committee to be performed by the administrative or supervisory body as a whole, provided, at least, that when the chairman of such a body is an executive member, s/he is not the chairman of the audit committee[210].

4.1 Existence and composition of audit committee

Figure II-4-1: **Audit committees in EU – per company type**

Proportion of companies disclosing the existence of:



The vast majority of companies analysed in the EU (81 percent of all companies analysed) have set up an audit committee or attributed such functions to the board of directors (5 percent of all companies analysed). Estonia and Bulgaria, where only a minority of companies analysed have set up audit committees, are the exceptions. About half the companies analysed in Denmark have attributed the functions of the audit committee to the board of directors.

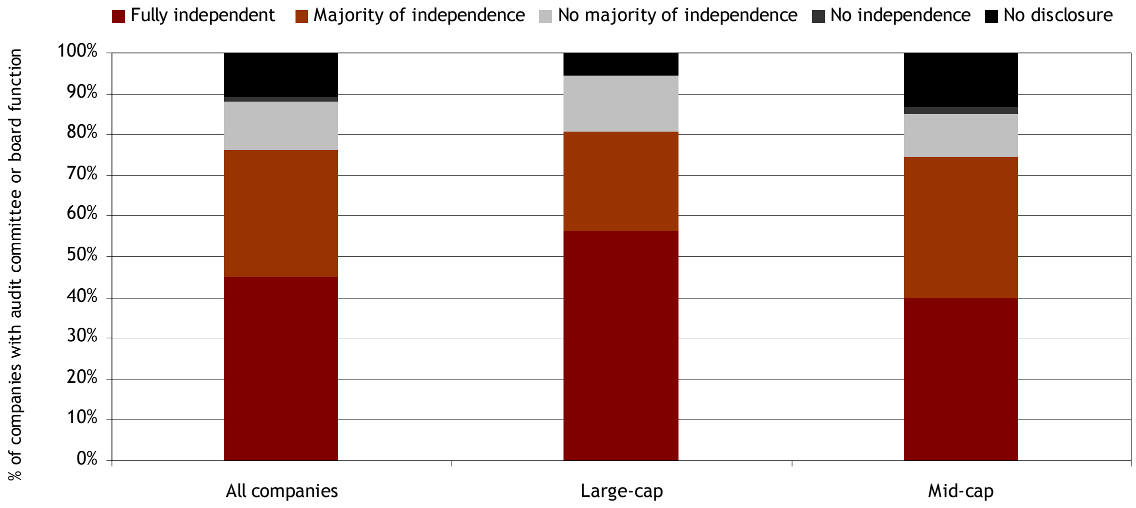
Virtually all large-cap companies[211] have set up a separate audit committee. The only exceptions are to be found in Greece, where one large-cap company did not set up such a committee or attributed such functions to the board of directors. Furthermore, one large-cap company in Denmark attributed the functions of the audit committee to the board of directors.

18 percent of all mid-cap companies have not set up a separate audit committee or attributed such functions to the board of directors. With the exception of Estonia and Bulgaria, where only a minority of companies have set up such committee, in each of eight other markets there is at least one company where no such committee or board function was set up. However, all mid-cap companies analysed in Denmark, Germany, Hungary, Ireland, Netherlands, Spain, Sweden, and the UK have set up such functions.

[210] See Section I-2.1.4 for more information. EU Directive on Statutory Audit 2006/43/EC, Article 41. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:157:0087:0107:EN:PDF.
[211] No large-cap companies were identified in Bulgaria or Estonia.

Figure II-4-2: **Independence on the audit committee in EU - per company type**

Average proportions of independence on the audit committee:

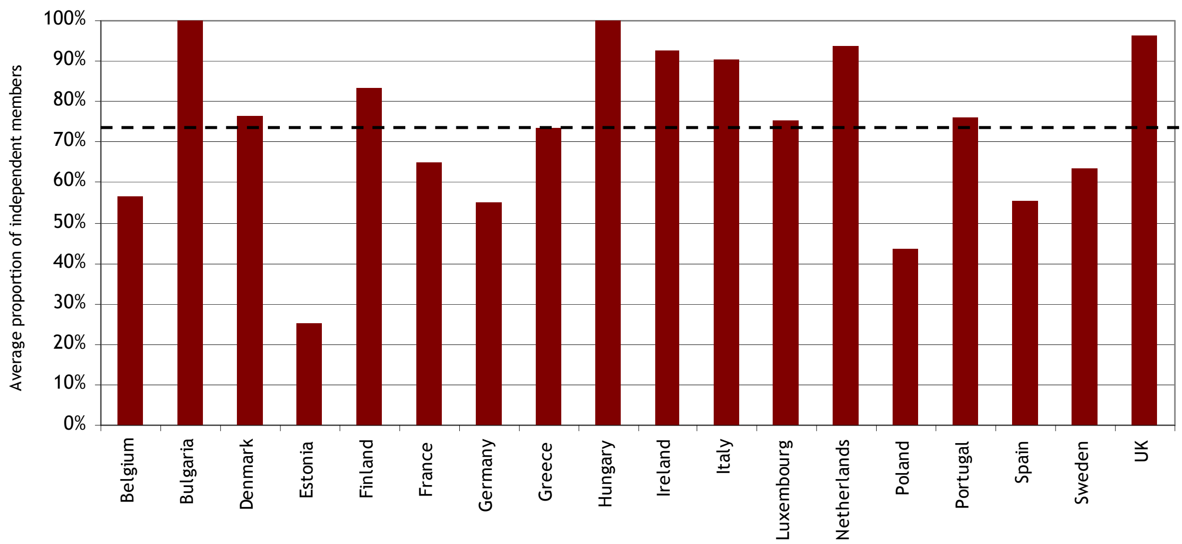


Almost half of the companies analysed that have set up an audit committee have a fully independent audit committee. However, 12 percent do not have a majority of independent members and 1 percent of companies analysed with an audit committee have not indicated a single independent member.

The trend between having an audit committee vs. not having one between large- and mid-cap companies continues when comparing independence levels at the audit committees of these companies. More than half of the large-cap companies analysed have fully independent audit committees. In the group of mid-cap companies only 40 percent are fully independent. The proportion of companies without a single identified independent director in mid-cap companies is to 13 percent, versus 5 percent for large-cap companies.

*Figure II-**4-3**:* **Independence on the audit committee in EU – per country**

Average proportions of independence on the audit committee:



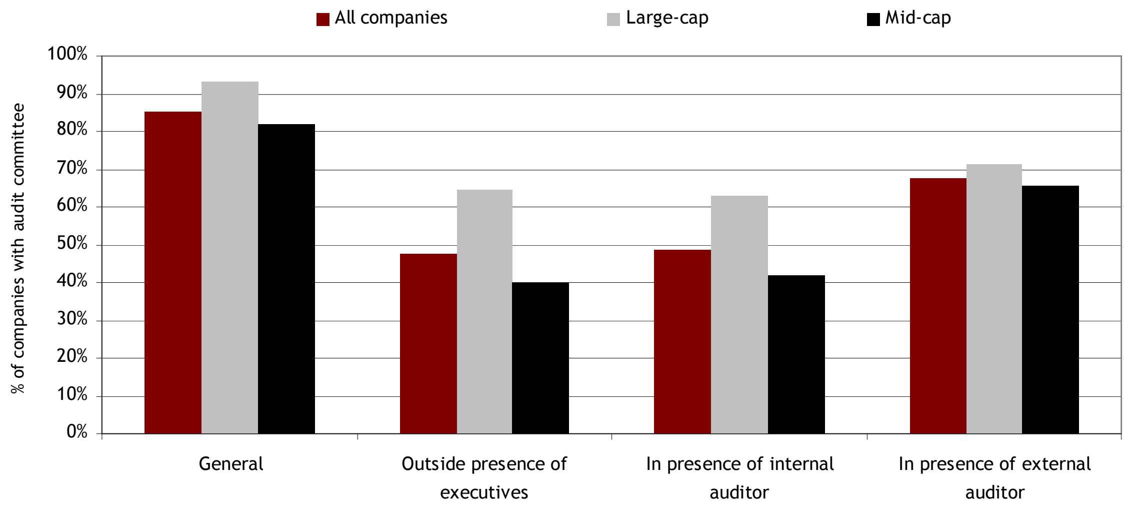
Excluding Bulgaria and Estonia – which are not representative due to the limited number of companies with an audit committee - independence levels on audits committee are relatively high in Hungary, Ireland, Italy, the Netherlands, and the UK. Belgium, Germany, Poland, and Spain are situated well below the EU average of 73 percent of independent members on audit committees. The EU average for large-cap companies is 80 percent, and 71 percent for mid-cap companies.

4.2 Audit committee functioning

To examine the functioning of the audit committee, we have looked at disclosure on audit committee meetings. We have furthermore analysed disclosure regarding the responsibilities towards the external and the internal auditor, access to outside advisors, and the disclosure of charters and activity reports.

Figure II-4-4: **Disclosure on number of meetings of audit committees in EU - per company type**

Proportion of companies with audit committees disclosing number of meetings:

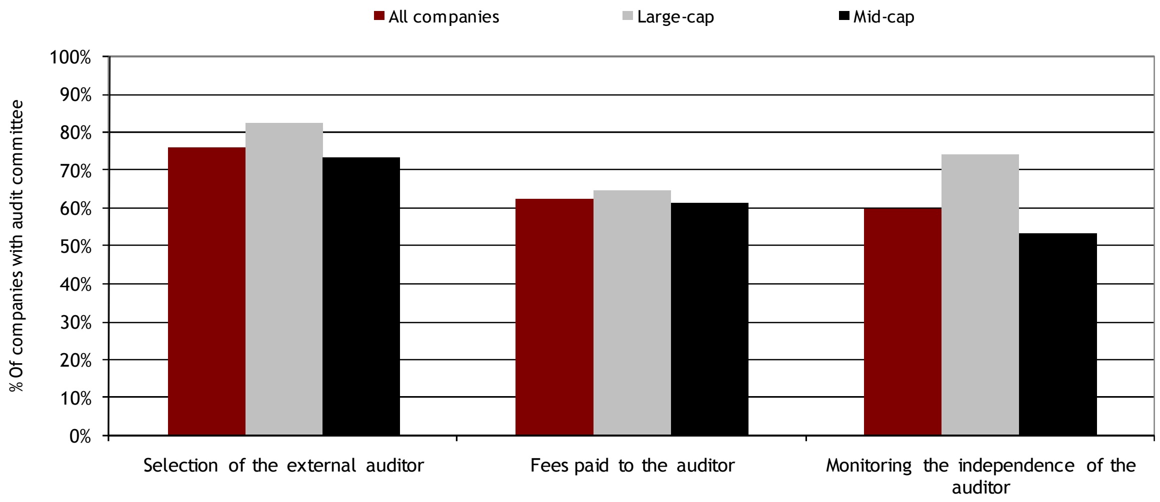


Most companies (85 percent) with an audit committee have disclosed the number of meetings held. Slightly fewer than half of those companies have specified the number of meetings outside the presence of executives or in presence of the internal auditor. About two-thirds of those companies have disclosed the meetings held in the presence of the external auditor. Disclosure standards are higher for large-cap companies as shown in the graph above.

Belgium, France, Ireland, the Netherlands, and the UK are the exceptions as a large majority of all companies disclose information on the number of meetings held, generally, outside the presence of executives and in presence of the internal auditor as well as the external auditor.

Figure II-4-5: **Disclosure of responsibilities of the audit committee towards the external auditor in EU – per company type**

Proportion of companies with audit committee disclosing responsibilities related to:

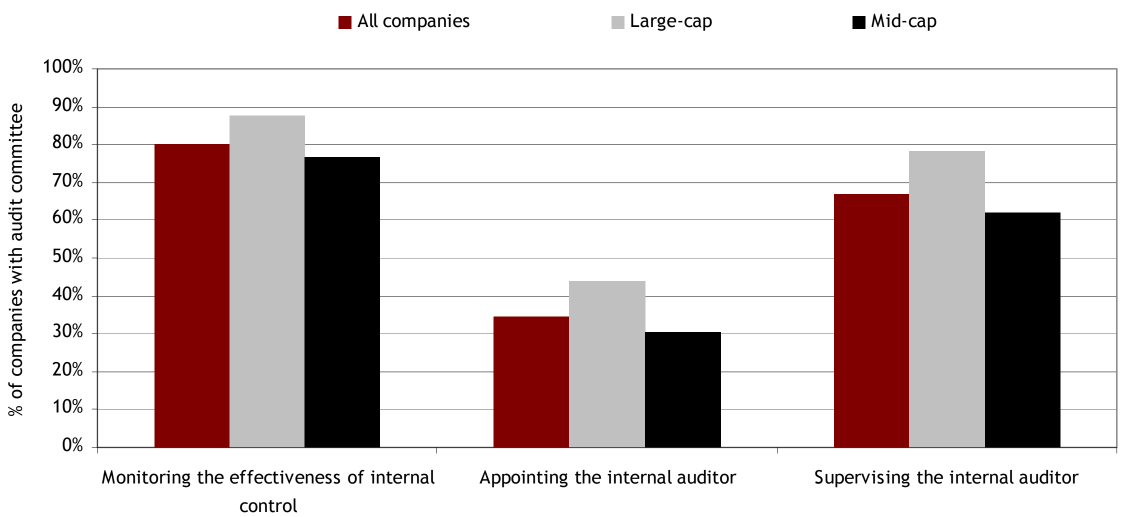


Overall, 76 percent of the companies with an audit committee have disclosed the responsibility of the audit committee in participating in the selection process of the external auditor. 62 percent of such companies have disclosed the responsibility of the committee in supervising the fees paid to the auditor, and 60 percent in monitoring the independence of the external auditor.

A difference exists between large-cap companies and mid-cap companies for audit committees stating that, "monitoring the independence of the external auditor" is part of their key responsibilities. This responsibility has been disclosed by all Irish and UK companies as well as by the vast majority of companies analysed in the Netherlands and Spain.

Figure II-4-6: **Disclosure of responsibilities of the audit committee towards the internal auditor in EU – per company type**

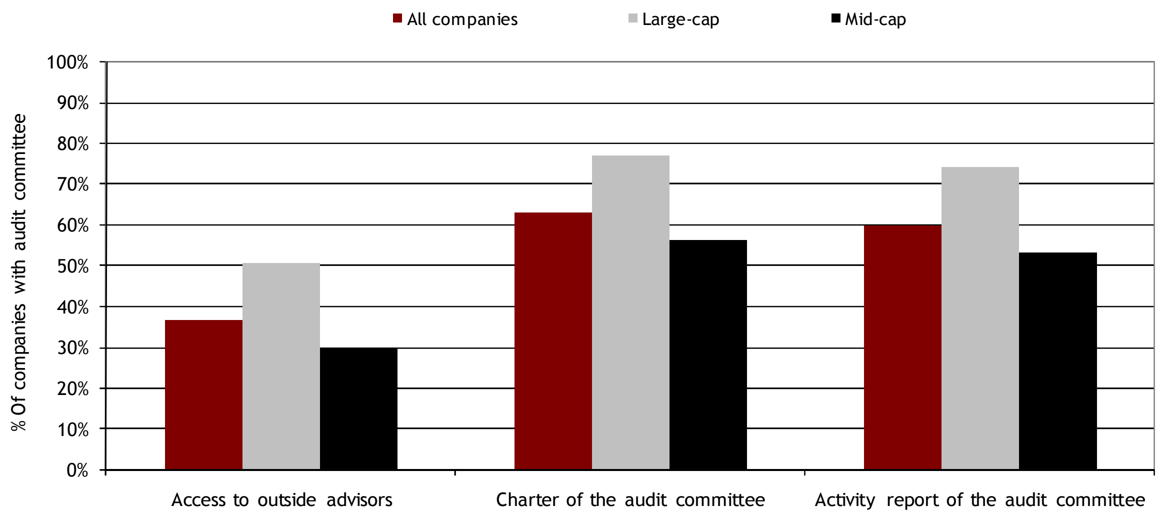
Proportion of companies with audit committee disclosing responsibilities related to:



Four out of five companies with an audit committee have disclosed the responsibility of the committee in monitoring the effectiveness of the internal control. Approximately one-third of such companies specified that the committee is responsible for appointing the internal auditor and two-thirds mentioned that the committee is involved in supervising the internal auditor. Large-cap companies, overall, disclose more information on the responsibility of the audit committee towards the internal auditor. The disclosure of responsibilities of the audit committee towards the internal auditor is especially high in Belgium, Ireland, Spain, and the UK.

Figure II-4-7: **Disclosure of other issues by the audit committee in EU – per company type**

Proportion of companies with audit committee disclosing:



More than one-third of the companies with an audit committee have disclosed the prospect of the committee in having access to outside advisors, 63 percent disclose an audit committee charter, and 60 percent disclose an activity report of the audit committee. Significant differences exist between large-cap companies and mid-cap companies.

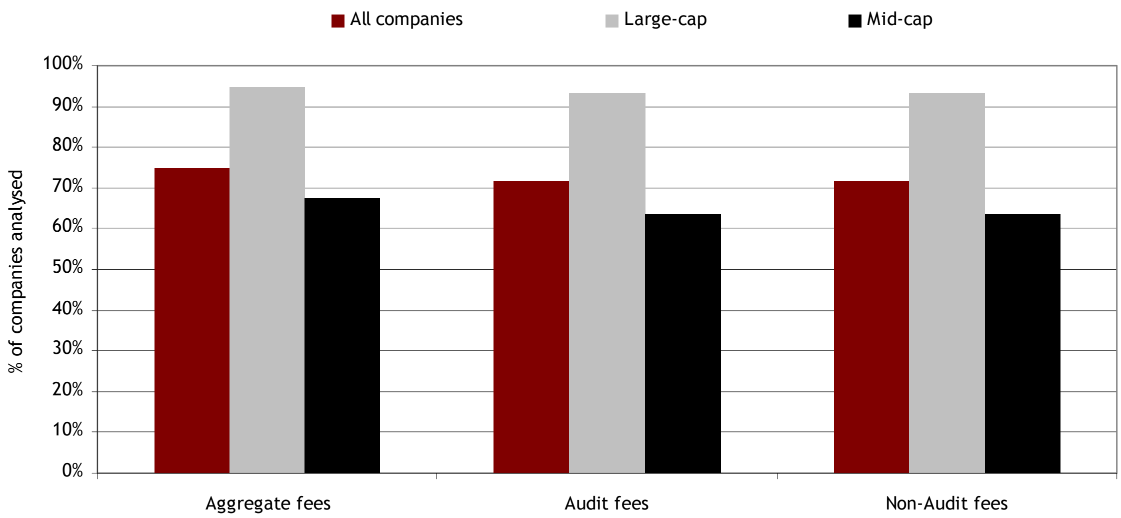
Charters of audit committee are disclosed by at least two-thirds of all companies analysed in Belgium, Hungary, Ireland, the Netherlands, Spain, Sweden, and the UK. Activity reports of the past year are disclosed by at least two-thirds of all companies analysed in Belgium, France, Hungary, Ireland, the Netherlands, and the UK.

4.3 Fees paid to external auditor

According to the amended Seventh Directive on consolidated accounts of companies with limited liability 83/349/EEC, companies should separately disclose: the total fees for the financial year charged by the statutory auditor or audit firm for the statutory audit of the consolidated accounts, the total fees charged for other assurance services, the total fees charged for tax advisory services and the total fees charged for other non-audit services. The deadline for transposition in the Member States was June 29, 2008, but as of July 1st 2009 there were still five Member States that had not yet transposed the article regarding disclosure of audit fees into company law[212].

Figure II-4-8: **Disclosure of fees of the external auditor in EU – per company type**

Proportion of companies disclosing:



Only a slight difference can be found between companies only disclosing the aggregate audit fees paid and companies disclosing the breakdown between fees for audit services and fees paid for non-audit services. Generally, if companies disclose information on fees paid to the auditor, they do provide an overview of which fees are paid for normal audit services as well as fees paid for other services.

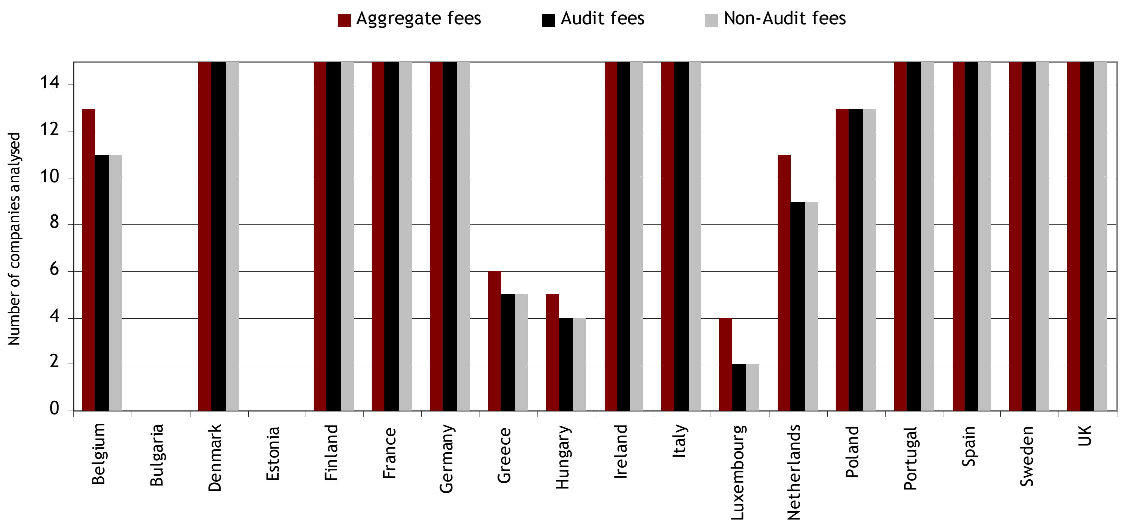
A significant difference between large-cap companies and mid-cap companies exists. Overall, 95 percent of all large-cap companies disclose the fees paid to the external auditor. In fact, two Greek companies and two Luxembourg companies, out of a total of 74 companies analysed, have not disclosed such information. One Belgian company only disclosed the overall amount of fees paid to the auditor without further breakdown.

The disclosure standards are significantly lower when examining mid-cap companies. Of all mid-cap companies analysed, 67 percent disclose the total amount of fees paid to the external auditor.

[212] Amended Seventh Directive on the consolidated accounts of companies with limited liability: http://europa.eu/legislation_summaries/internal_market/single_market_capital/l26010_en.htm.

Figure II-4-9: **Disclosure of fees of the external auditor in EU – per country**

Number of companies disclosing:



On a country-by-country basis, either all companies in a market disclose details on audit fees or very few do. The exceptions seem to be Belgium, the Netherlands, and Poland where most, but not all, companies disclose such information. As shown in the graph above, no disclosure on fees paid to the external auditor could be found in Bulgarian and Estonian companies, and only a limited number of companies disclose such information in Greece, Hungary, or Luxembourg. Full disclosure (including breakdown into audit fees and non-audit fees) was observed in ten out of 18 Member States analysed: Denmark, Finland, France, Germany, Ireland, Italy, Portugal, Spain, Sweden, and the UK.

5 REMUNERATION

This section reviews disclosure levels on remuneration, including variable remuneration, pensions, benefits, and severance agreements. It also take a closer look at remuneration committees and shareholder involvement in remuneration setting.

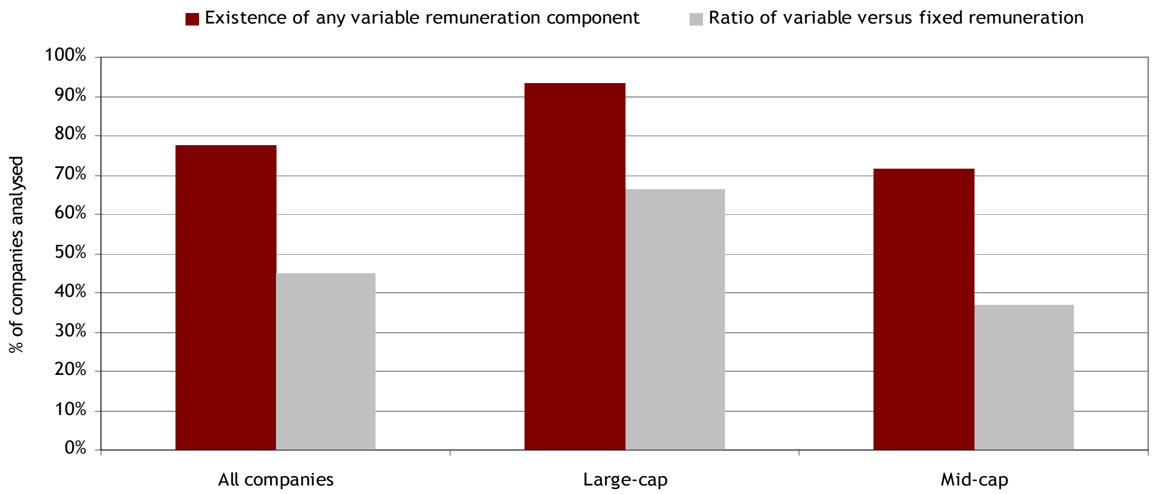
Executive remuneration has been an issue of debate for many years. Discussions have intensified recently against the backdrop of the global financial crisis. In December 2004, the European Commission issued Recommendation 2004/913/EC on remuneration of directors in listed companies. The recommendation aimed to increase transparency on remuneration issues and to advocate for a shareholder vote on share-based compensation as well as on a remuneration policy[213]. On April 29th, 2009, Recommendation 2004/913/EC on remuneration of directors in listed companies and Recommendation 2005/162/EC were complemented by two new non-binding recommendations, one of them concerning directors' remuneration in listed companies (2009/385/EC)[214].

5.1 Variable remuneration (short-term and long-term)

Amongst other things, Recommendation 2004/913/EC on the remuneration of directors in listed companies recommends that the remuneration statement should explain the relative importance of the variable and non-variable components of directors' remuneration and provide sufficient information on the performance criteria on which any entitlement to share options, shares or variable components of remuneration is based. Recommendation 2009/385/EC takes it one step further, recommending that variable components should be capped, and that the award of variable compensation should be subject to predetermined performance criteria.

Figure II-5-1: **Disclosure of variable remuneration components and the ratio versus fixed remuneration in EU – per company type**

Proportion of companies disclosing:



77 percent of all companies analysed disclose the existence of at least one variable remuneration component, as outlined in Figure II-5-1 above.

Only five large-cap companies, corresponding to 7 percent of the large-cap sample (1 Danish company, 2 Greek companies, and 2 Polish companies), did not disclose the existence of variable

[213] See Chapter I-3.2 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:385:0055:0059:EN:PDF.

[214] Commission Recommendation 2009/385/EC complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies, dated April 30th, 2009; available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:120:0028:0031:EN:PDF.

remuneration. The proportion of mid-cap companies not disclosing such information was significantly higher at 29 percent of all mid-cap companies.

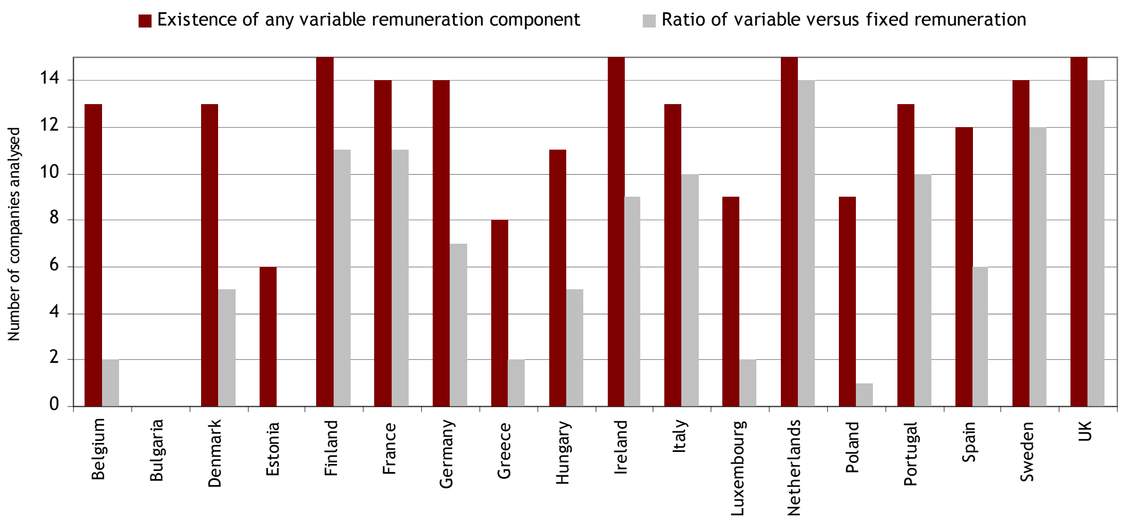
The proportion of companies not disclosing any variable remuneration component is highest among Bulgarian and Estonian companies. In contrast, all Finnish, Irish, Dutch, and UK companies indicated the existence of at least one form of variable remuneration.

Just over half the companies that disclose the existence of at least one form of variable remuneration have also published ex-ante information on the ratio of variable remuneration versus fixed remuneration.

For the variable remuneration component, there is a significant difference in disclosure practices between large-cap companies and mid-cap companies in terms of the ratio of variable remuneration versus fixed remuneration. 71 percent of the large-cap companies with disclosed variable remuneration disclose such information, whereas only 51 percent of mid-cap companies do.

Figure II-5-2: **Disclosure of variable remuneration components and the ratio versus fixed remuneration in EU - per country**

Number of companies disclosing:



As shown above in figure II-5-2, the highest levels of disclosure of variable remuneration versus fixed remuneration can be found in the Netherlands and the UK. In Bulgaria, Estonia, Greece, Luxembourg, and Poland, on the other hand, very few companies disclose such information.

5.1.1 Type of variable remuneration

Companies grant variable remuneration to executives in many forms. Short-term variable remuneration is typically given as an annual cash bonus, whereas long-term variable remuneration often takes the form of an equity grant. In this Study, the following variable remuneration components are identified: annual bonus plans[215], stock option plans[216], performance share plans[217],

[215] An annual bonus plan is defined as a short-term performance related remuneration component over a 1-year span.
[216] A stock option plan is defined as a long-term remuneration component whereby the beneficiary receives the right to purchase a share at a pre-defined price after a period longer than 1 year.
[217] A performance share plan (or conditional share plan) is defined as a long-term performance related remuneration component, whereby shares are granted (or vested) to the beneficiary after the achievement of pre-defined results.

deferral plans with matching elements[218], matching plans[219], phantom share plans[220], and phantom stock option plans[221].

Figure II-5-3: **Type of variable remuneration components in EU – per country**

Country	Annual bonus plan	Stock option plan	Performance share plan	Deferral plan with matching	Matching plan	Phantom share plan	Phantom stock option plan
Belgium	13	8	3	0	1	0	0
Bulgaria	0	0	0	0	0	0	0
Denmark	10	11	2	0	0	0	2
Estonia	3	3	0	0	0	0	0
Finland	14	10	11	0	0	0	1
France	13	13	11	0	0	0	0
Germany	13	8	2	0	0	3	0
Greece	5	8	0	0	0	0	0
Hungary	9	5	1	0	0	0	1
Ireland	15	13	9	0	0	0	0
Italy	11	9	3	0	0	0	1
Luxembourg	8	6	2	0	0	1	0
Netherlands	15	10	11	1	2	2	0
Poland	4	7	1	0	0	1	1
Portugal	10	7	7	0	0	0	0
Spain	12	1	3	2	0	0	0
Sweden	14	6	6	0	4	0	2
UK	15	6	14	6	1	0	0
Total	184	131	86	9	8	7	8

As presented in the table above, three main types of variable remuneration can be identified in the EU: annual bonus plans (disclosed by 68 percent of all companies analysed), stock option plans (disclosed by 49 percent of all companies analysed), and performance share plans (disclosed by 32 percent of all companies analysed). No disclosure on the use of variable remuneration is identified in Bulgaria, and only three companies in Estonia disclose such information.

Significant differences exist between large-cap companies and mid-cap companies:

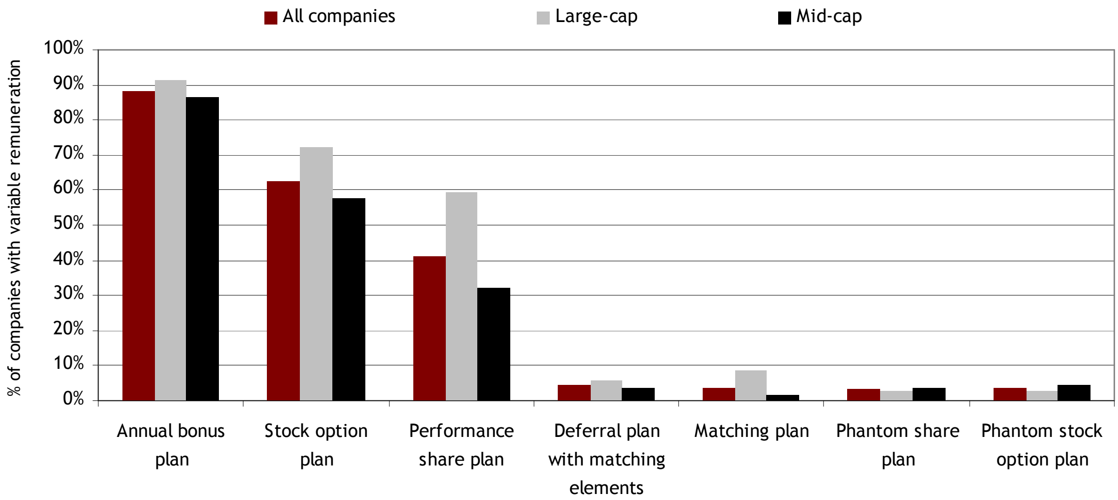
- 85 percent of large-cap companies disclose information on the existence of an annual bonus plan, compared to 62 percent of mid-cap companies;
- 68 percent of large-cap companies disclosed information on the existence of a stock option plan, compared to 41 percent of mid-cap companies; and
- 55 percent of large-cap companies disclosed information on the existence of performance shares, compared to 23 percent of mid-cap companies.

The use of the other types of plans is rather marginal at the companies analysed.

[218] A deferral plan with matching elements is defined as a remuneration component whereby a short-term performance related component is invested in company shares which can be matched after a pre-defined period longer than one year.
[219] A matching plan is defined as a long-term remuneration component whereby the beneficiary has invested in shares which can be matched after a pre-determined period.
[220] A phantom share plan is defined as a long-term performance related remuneration component. It operates like a performance share plan, but the transaction is carried out in cash, rather than in shares.
[221] A phantom stock option plan is defined as a long-term performance related remuneration component. It operates like a stock option plan, but the transaction is carried out in cash, rather than in shares.

Figure II-5-4: **Type of variable remuneration components in EU – per company type**

Proportion of companies with a variable remuneration component disclosing the existence of:



Of the companies that disclose at least one variable remuneration component - as shown above in figure II-5-4 – most companies (88 percent overall) disclose the existence of an annual bonus plan. For long-term remuneration, stock options and performance shares are most common, but there is a significant difference between large-cap companies and mid-cap companies, especially for performance shares. 59 percent of all large-cap companies (disclosing the existence of a variable remuneration component) have issued a performance share plan compared to 32 percent of all mid-cap companies.

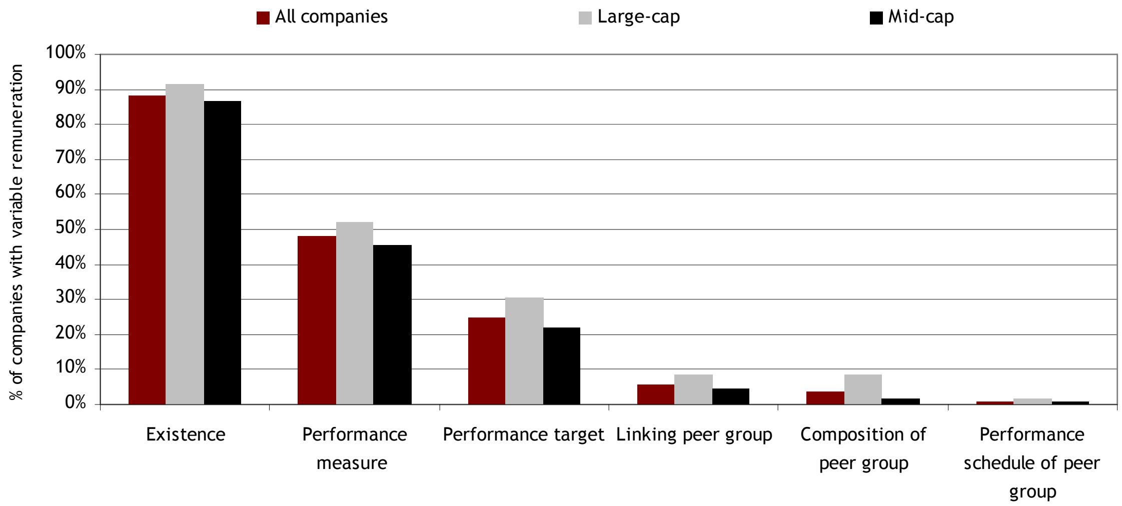
5.1.2 Disclosure of performance criteria

When analysing variable remuneration components, we focus on the information provided on annual bonuses, stock option plans, and performance shares, given the limited number of occurrences of other types of plans.

In the first instance, the plans are examined in order to determine whether or not the companies disclose the existence and the nature of one or several performance measures, such as "Earnings Per Share," and, if this the case, whether or not the company discloses a performance period (for the long-term plans). In the second instance, we ascertain whether or not the companies disclose further information, such as linking of the performance measure to the performance of a peer group of companies (and if so, whether or not the composition of the peer group is disclosed), as well as information on the vesting schedule of the awards or the disclosure of a performance target to be achieved.

Figure II-5-5: **Overview of performance information provided on annual bonus plans in EU - per company type**

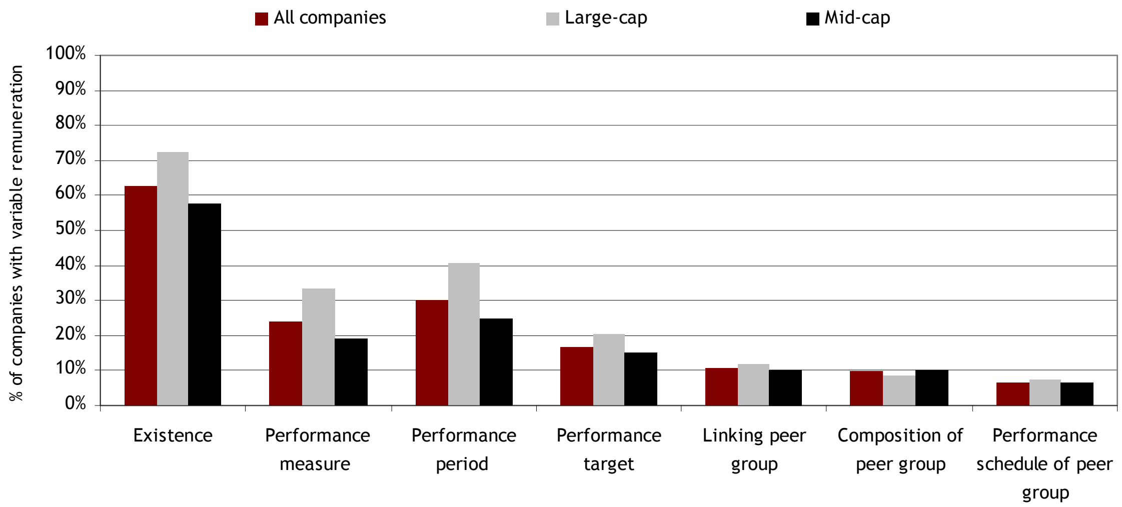
Proportion of companies with a variable remuneration component disclosing:



Of all companies that disclose the existence of a variable remuneration component, 88 percent disclose the existence of an annual bonus plan. Of the companies that disclose the existence of an annual bonus, slightly over half also disclose a basic performance measure. The availability of such information is especially evident at Dutch, Finnish, Irish and UK companies. 25 percent of all companies disclose information on the performance target, but very few companies disclose linking the performance objectives to a peer group. This can probably be explained by the fact that peer group comparisons are rare for annual bonus plans, which often have operational performance targets.

Figure II-5-6: **Overview of performance information provided on stock option plans in EU - per company type**

Proportion of companies with a variable remuneration component disclosing:



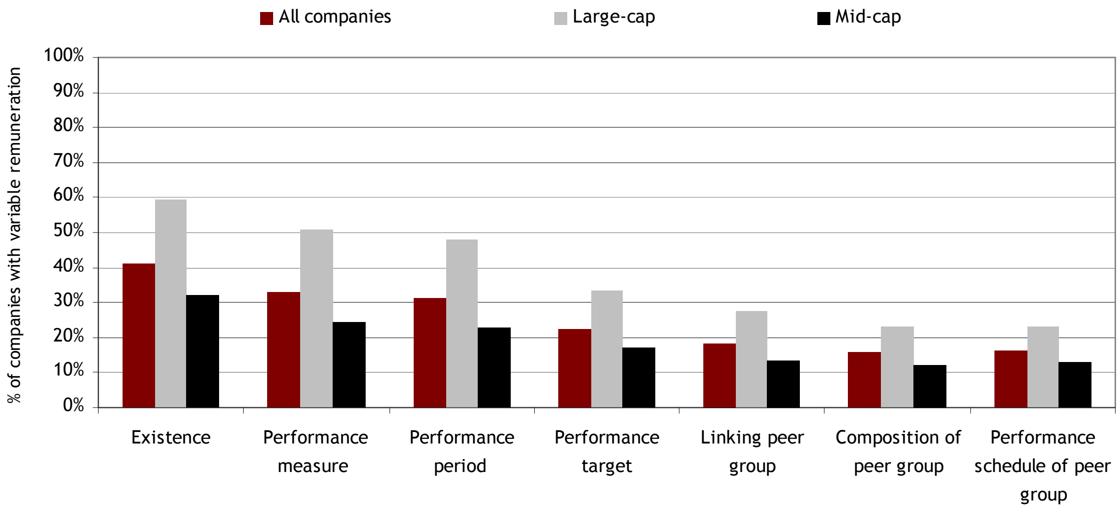
Of all companies that disclose the use of variable remuneration components, 63 percent disclose the existence of a stock option plan. 23 percent of these companies disclose the existence of a basic performance measure for the stock options, and 17 percent disclose detailed information on the performance target. Significant differences exist between large-cap companies and mid-cap companies for the disclosure of basic performance measures and performance periods.

Information regarding linking a performance measure to the performance of a peer group and the composition of such a peer group is provided by a limited number of companies. Information on the vesting schedule within the peer group is even less prevalent.

In Germany, Ireland, the Netherlands and the UK, most of the companies with a stock option plan disclose at least a basic performance measure for the award or vesting of stock options. These are also the markets where such a recommendation exists in the corporate governance code.

Figure II-5-7: **Overview of performance information provided on performance share plans in EU - per company type**

Proportion of companies with a variable remuneration component disclosing:



Of all companies that disclose the use of variable remuneration components, 41 percent disclose the existence of a performance share plan. 75 percent of these companies disclose the existence of a basic performance measure, and 54 percent disclose detailed information on the performance target. The picture for performance shares appears quite different from that of stock option plans. Detailed information on performance targets is less prevalent, but there is still a notable difference between stock option plans and performance share plans in this respect. On an individual country basis, all UK companies have disclosed all information on performance measures, periods, peer groups and targets. As with disclosure on stock option plans, large-cap companies tend to disclose more information than mid-cap companies.

In the Study, the extent to which companies give an overview of past performance to justify the variable remuneration received by its executives is also examined. For instance, in the event a company has a share-based plan using Total Shareholder Return compared to peers as a performance criterion, shareholders could expect such company to show its Total Shareholder Return performance corresponding to the subsequent performance period.

Such disclosure currently seems very limited. Only 13 percent of companies disclose ex-post performance for annual bonus plans, with most of those companies located in the UK and the Netherlands[222].

[222] Nine UK companies and seven Dutch companies disclose such information. In other markets, no more than two companies disclose ex-post information regarding annual bonuses.

In the EU, only 4 percent of the companies disclose such ex-post information on stock option plans, and about 10 percent on performance share plans. For performance share plans and stock option plans, as with annual bonus plans, Dutch and UK companies are better at disclosing such information than companies in other markets[223]. The low figures could, however, be explained, partly by the fact that only 23 percent of the companies attached performance criteria to stock options in the first place, and partly because performance share plans did not become widespread until well into the 2000s, which means that performance periods may not yet have come to an end.

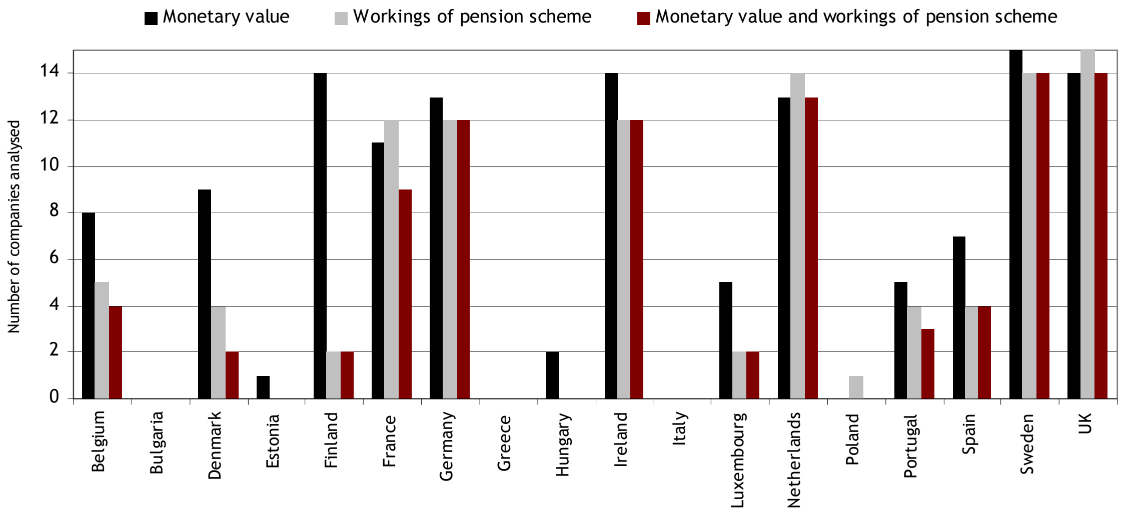
5.2 Other remuneration disclosure

Recommendation 2004/913/EC on remuneration of directors in listed companies urges companies to include a description of the main characteristics of supplementary pension or early retirement schemes for directors in the remuneration statement. Furthermore, information on the total estimated value of non-cash benefits should be disclosed as well. The remuneration statement should also summarise and explain the company's policy with regard to the terms of the contracts of executive directors, including the applicable notice periods and details of provisions for termination payments and other payments linked to early termination under contracts for executive directors.

5.2.1 Pensions

Figure II-5-8: **Disclosure of information on pension benefits in EU – per country**

Number of companies disclosing:



Whereas almost half of the companies disclose information on pension benefits (49 percent of all companies analysed), only 34 percent of all companies analysed disclose the monetary value and explain the functioning of the company's pension scheme(s). Forty nine percent of all large-cap companies and 28 percent of all mid-cap companies disclose this information. For pension disclosure, there is large variation between markets. Whereas no Bulgarian, Estonian, Greek, Hungarian, Italian, or Polish company disclose such information, at least 80 percent of Dutch, German, Irish, Swedish, and UK companies do.

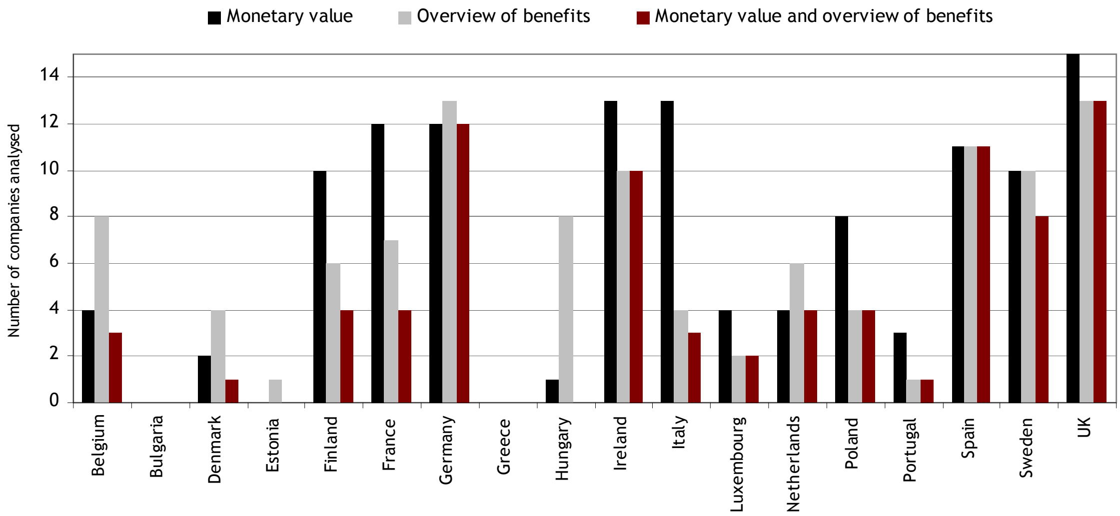
[223] 2 out of 6 UK companies and 3 out of 10 Dutch companies disclose such information on stock option plans. In addition, one Greek and one Italian do. No other company in any other market discloses ex-post information regarding stock option plans. 8 out of 14 UK companies and 6 out of 11 Dutch companies disclose such information on performance share plans. In addition, in each of Finland, France, Hungary, and Sweden, one company does. No other company in any other market discloses ex-post information regarding performance share plans.

5.2.2 Benefits

Benefits are made up of various forms of compensation in kind, such as housing, insurance, and company cars, provided to employees in addition to their normal salaries.

Figure II-5-9: **Disclosure of information on benefits in EU - per country**

Number of companies disclosing:



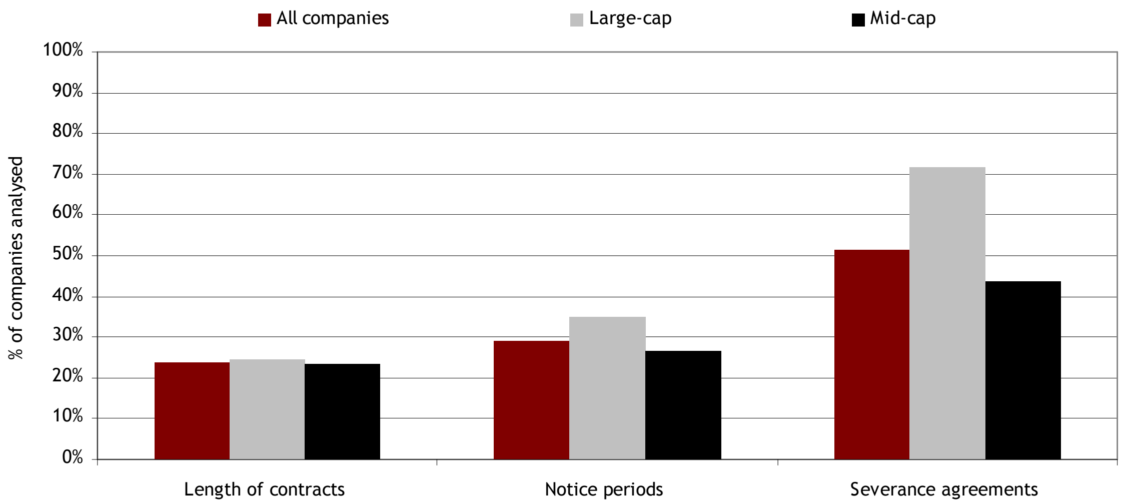
Almost half of the companies disclose information on the monetary value of benefits (45 percent of all companies analysed). This practice is prevalent in Finland, France, Germany, Ireland, Italy, Spain, Sweden, and the UK. A minority (30 percent of all companies analysed) also give an overview of the benefits, explaining what these benefits represent. This practice is prevalent in fewer Member States, notably in Germany, Ireland, Spain, Sweden, and the UK.

When it comes to providing complete information, 39 percent of all large-cap companies and 26 percent of all mid-cap companies disclose such information. As shown above, not a single Bulgarian, Estonian, Greek, or Hungarian company discloses such information, whereas at least a majority of all German, Irish, Spanish, Swedish, and UK companies do.

5.2.3 Executive contracts and severance agreements

Figure II-5-10: **Disclosure of information on executive contracts and severance agreements in EU – per company type**

Proportion of companies disclosing:



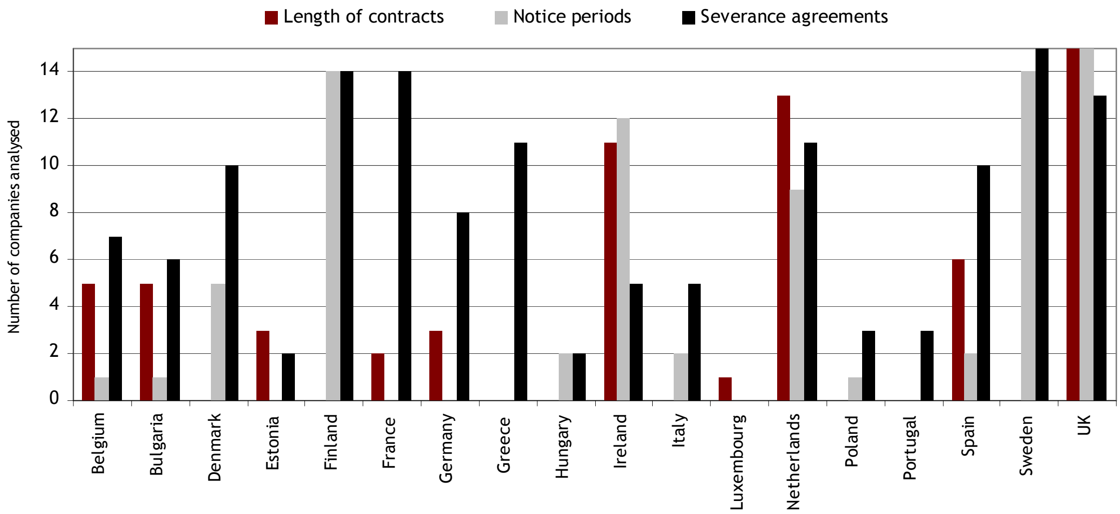
At the EU level, 24 percent of all companies analysed disclose information on the length of executive's contracts, with no significant difference between large-cap companies and mid-cap companies.

29 percent of all companies analysed disclose some information on notice periods, and 51 percent of all companies analysed disclose information on severance agreements for executives. Here, a significant difference is observed between large-cap companies and mid-cap companies, especially in relation to disclosure on severance agreements. The disclosure standards for large-cap companies are clearly higher than for mid-cap companies.

In Finland, Sweden, and the UK, almost all companies disclose complete information in the area of severance agreements (and executive contracts for the UK), whereas such disclosure is very limited in Estonia, Hungary, Luxembourg, Poland, and Portugal.

Figure II-5-11: **Disclosure of information on executive contracts and severance agreements in EU - per country**

Number of companies disclosing:



When specifically looking at severance agreements, of the companies disclosing information, 62 percent express severance in terms of number of years of fixed remuneration. 20 percent of all companies disclosing information on severance agreements express this in an alternate way, usually as a multiple of salary and bonus or as a fixed amount. Another 18 percent of all companies disclosing information on severance agreements have indicated that no severance agreement exists between the company and the executive beneficiary. This indication of no severance agreement between company and executive is especially prevalent in Bulgaria, France, and Greece.

In comparing practices of large-cap companies and mid-cap companies, both groups primarily express severance in years of fixed salary (68 percent and 58 percent respectively). A more significant difference is in the lack of a severance agreement between company and executive. This seems to be more prevalent in mid-cap companies, where 23 percent of all companies disclosing information on severance have indicated that no such agreement exists, compared to 9 percent for large-cap companies[224].

[224] Four such companies have been identified in Greece and one in France.

5.3 Determining executive remuneration

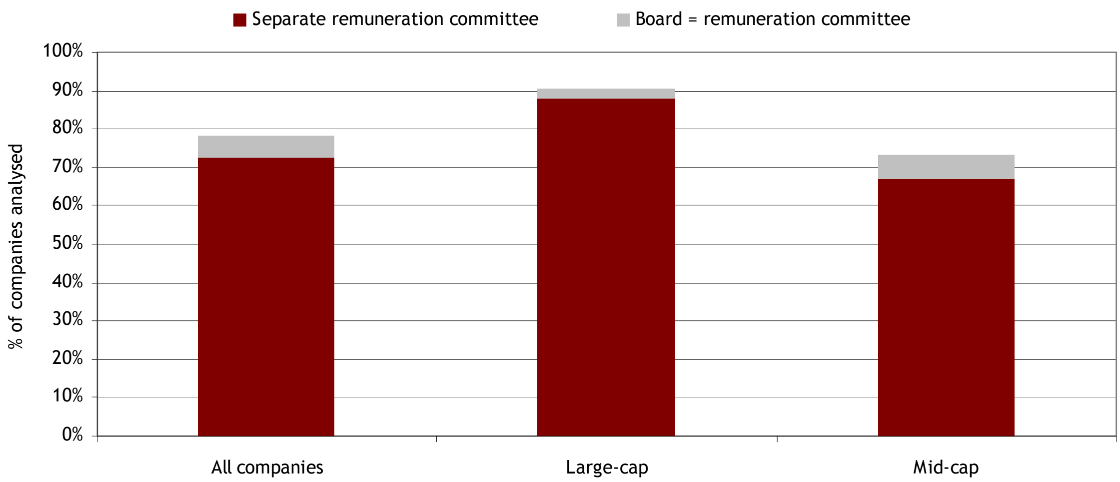
EC Recommendation 2004/913/EC stipulates that information concerning the preparatory and decision making process used for determining the company's remuneration policy for directors should be disclosed. This should include information, if applicable, about the mandate and composition of a remuneration committee, the names of external consultants whose services have been used in determination of the remuneration policy, and the role of the shareholders' annual general meeting.

5.3.1 Remuneration committees

The creation of remuneration committees was proposed by the European Commission in the 2005 Commission Recommendation, alongside the creation of nomination and audit committees. More recently in 2009 the issue of remuneration committees was more formally introduced in European legislation through the 2009 European Commission Recommendation on remuneration, which discusses the composition, role and functioning[225].

Figure II-5-12: **Remuneration committees in EU – per company type**

Proportion of companies disclosing:



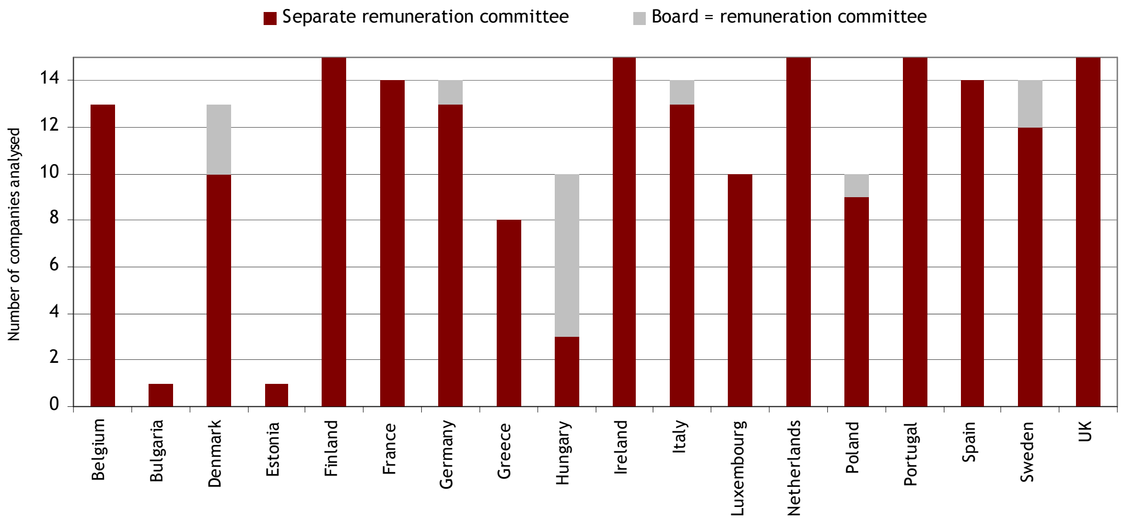
73 percent of companies analysed have set up a separate remuneration committee. Slightly over 20 percent of all companies, however, have not set up such a committee, nor have they formally attributed this specific function to their board of directors.

91 percent of all large-cap companies have set up a remuneration committee or indicated that the board of directors has been attributed this function. The corresponding figure for mid-cap companies is 67 percent.

[225] See Chapter I-3.1.4.

Figure II-5-13: **Remuneration committees in EU - per country**

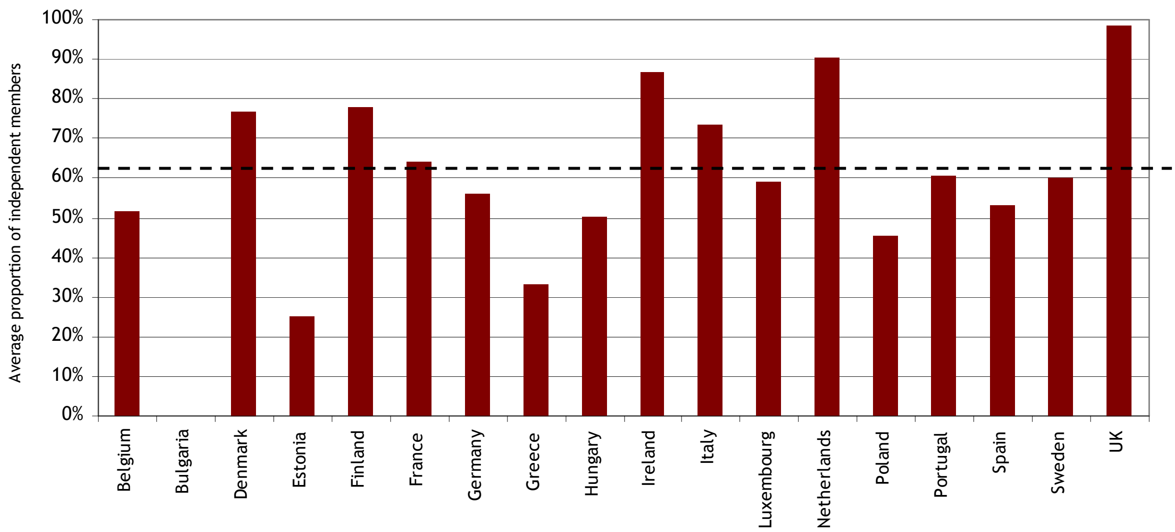
Number of companies disclosing:



All companies analysed in Finland, Ireland, the Netherlands, Portugal, and the UK have set up a separate remuneration committee. In Bulgaria and Estonia, only one company in each Member State from the sample has set up a remuneration committee. In all other markets, at least a majority of the companies analysed have set up such a committee or attributed the function to the board. In Hungary, most of the companies analysed indicated having attributed the functions of the remuneration committee to the entire board of directors.

Figure II-5-14: **Independence on the remuneration committee in EU - per country**

Average proportions of independence on the remuneration committee:



On average, 62 percent of the members of the remuneration committees in the sample companies are designated as independent by those companies where they are located. In particular Dutch, Irish, and UK companies tend to have a remuneration committee composed of a large percentage of independent members.

Average independence of the remuneration committee in large-cap companies is 74 percent, whereas average independence in mid-cap companies is 58 percent.

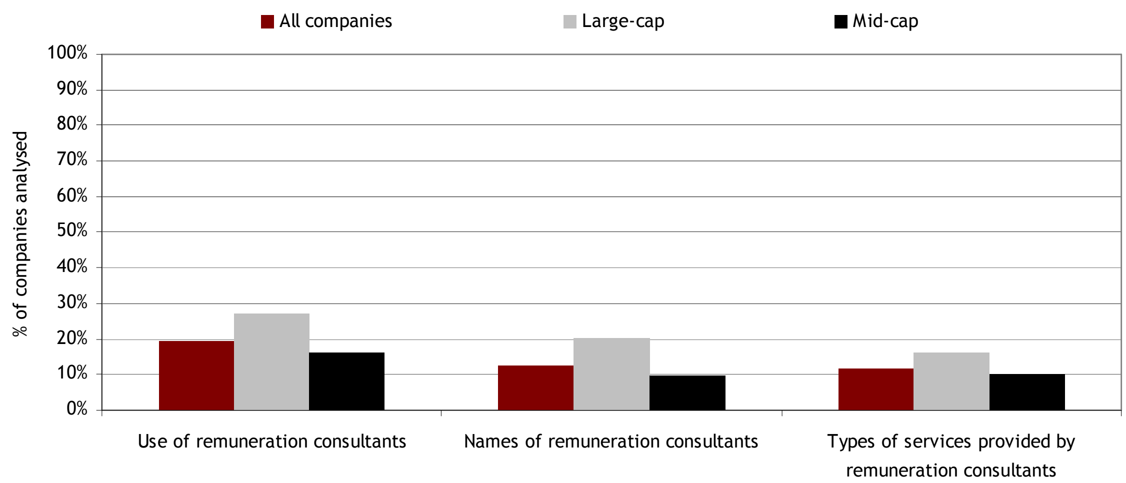
Of all companies that have set up a separate remuneration committee, 94 percent have indicated that the committee has a non-executive chairman, and, in 69 percent of these companies, the chairman is independent.

5.3.2 Remuneration consultants

Remuneration consultants are frequently used as a source of advice and information by the remuneration committee in order to ensure that companies are appropriately rewarding their employees.

Figure II-5-15: **Information provided on remuneration consultants in EU – per company type**

Proportion of companies disclosing:



As shown above, about one-fifth of all companies disclose having worked with remuneration consultants. Such disclosure is prevalent mainly in Ireland, the Netherlands, and the UK. All UK companies indicating the use of remuneration consultants also provide their name and the type of services provided. Such information is provided, to a lesser extent, in Ireland and the Netherlands. In eight markets, Bulgaria, Denmark, Estonia, Germany, Greece, Hungary, Poland, and Portugal, not a single company claimed to have worked with remuneration consultants.

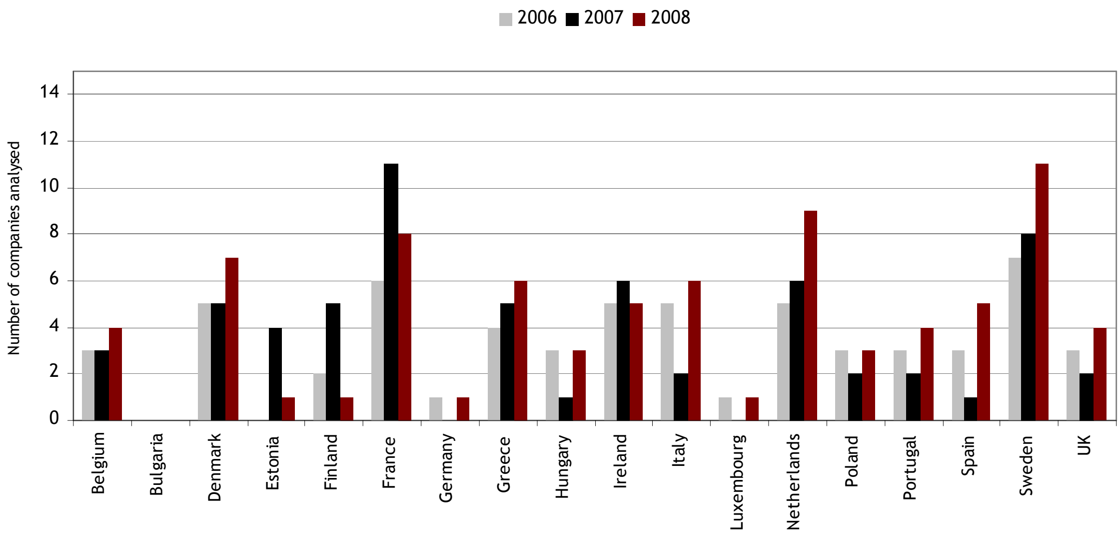
5.4 Shareholder involvement in remuneration

In most Member States, shareholders are involved in approving some type of executive remuneration. In most instances shareholder involvement is related to the approval of share-based plans. Shareholders may also be asked to approve the remuneration of the board of directors. In a number of Member States shareholders approve the remuneration policy (ex-ante) or remuneration report (ex-post). These shareholder decisions can be binding or non-binding.

EC Recommendation 2004/913/EC contains two main provisions on shareholder involvement in remuneration. One is a recommendation that a company's remuneration policy should be an explicit item, either binding or advisory, on the agenda of annual general meetings under a separate voting item. The second provision is a recommendation that share-based remuneration schemes should be subject to the approval of shareholders by way of a separate resolution at the annual general meeting prior to their adoption[226].

Figure II-5-16: **Vote on share based remuneration in EU – per country**

Number of companies featuring votes on share based remuneration:



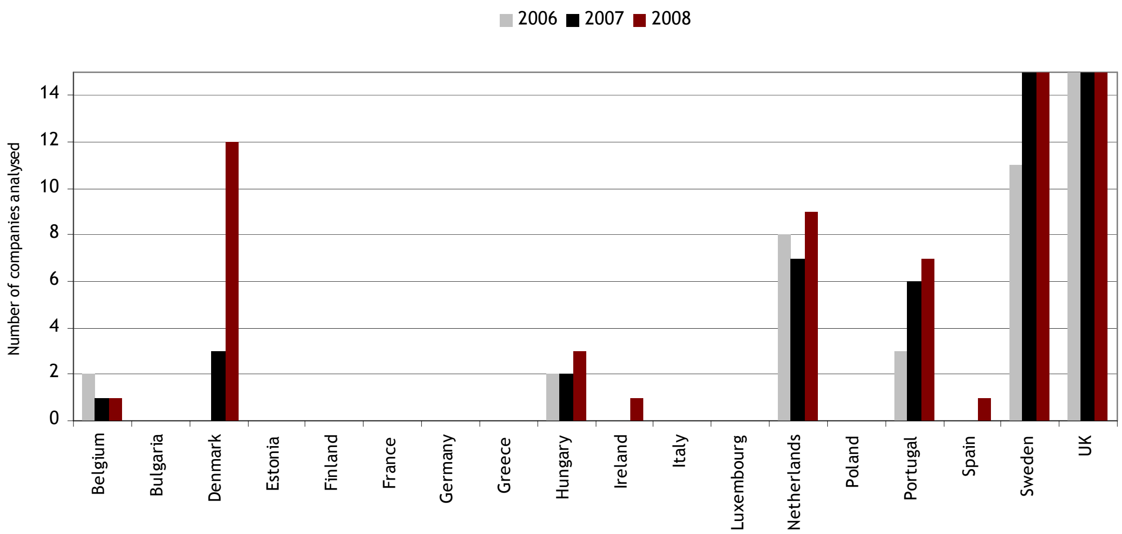
At EU level, shareholders voted on share-based remuneration at 29 percent of the companies in 2008. There is a clear trend of an increasing number of voting resolutions on share-based remuneration at EU level; the number of such votes increased by 34 percent from 2006[227] to 2008. Most of this increase is derived from mid-cap companies where the proportion rose from 16 percent in 2006 to 25 percent in 2008. In large-cap companies, the corresponding increase was from 36 percent to 41 percent. It is, however, difficult to gauge whether this trend is due to more companies creating incentive plans or if companies that previously did not put share-based remuneration schemes up for shareholder approval have started doing so. The increase could be a result of one of or a combination of these two factors.

Between 2002 and 2009, a dozen countries worldwide undertook initiatives to add advisory or binding remuneration votes on ballots for shareholders. The EU markets that undertook this initiative include Denmark, Netherlands, Sweden, the UK, and, most recently, Italy. In addition, the Spanish, and to some extent the Portuguese, corporate governance codes currently recommend putting the remuneration report up for shareholder approval.

[226] For more information see Chapter I-3.2. Commission Recommendation 2004/913/EC on fostering an appropriate regime for the remuneration of directors of listed companies, dated December 14th, 2004; available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L: 2004:385:0055:0059:EN:PDF, last visited on June 10th, 2009.
[227] 22 percent of all companies analysed issued a proposal on share based remuneration in 2006.

Figure II-5-17: **Vote on remuneration reports or policies in EU - per country**

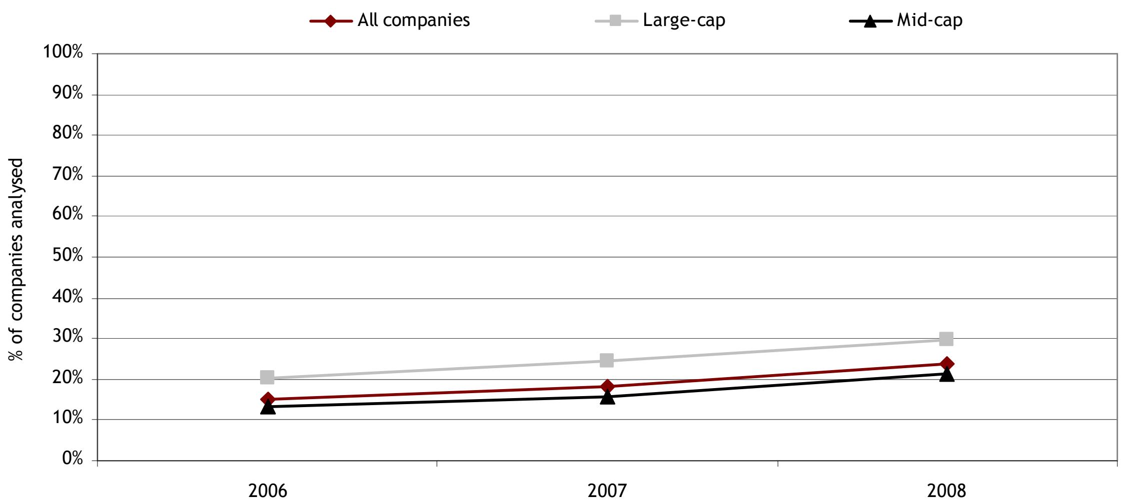
Number of companies featuring votes on remuneration reports or policies:



At EU level, shareholders in 24 percent of the companies voted on board remuneration as a separate resolution on the agenda in 2008. As shown above, remuneration reports or policies are particularly common in the UK and Sweden, but also quite frequent in Denmark, Portugal, and in the Netherlands. Depending on the market, the remuneration report/policy should be up for shareholder approval every year (Sweden and the UK) or only when significant changes are proposed (Denmark and the Netherlands).

Figure II-5-18: **Evolution of shareholder approval of remuneration reports or policies in EU - per company type**

Proportion of companies featuring votes on remuneration reports or policies:

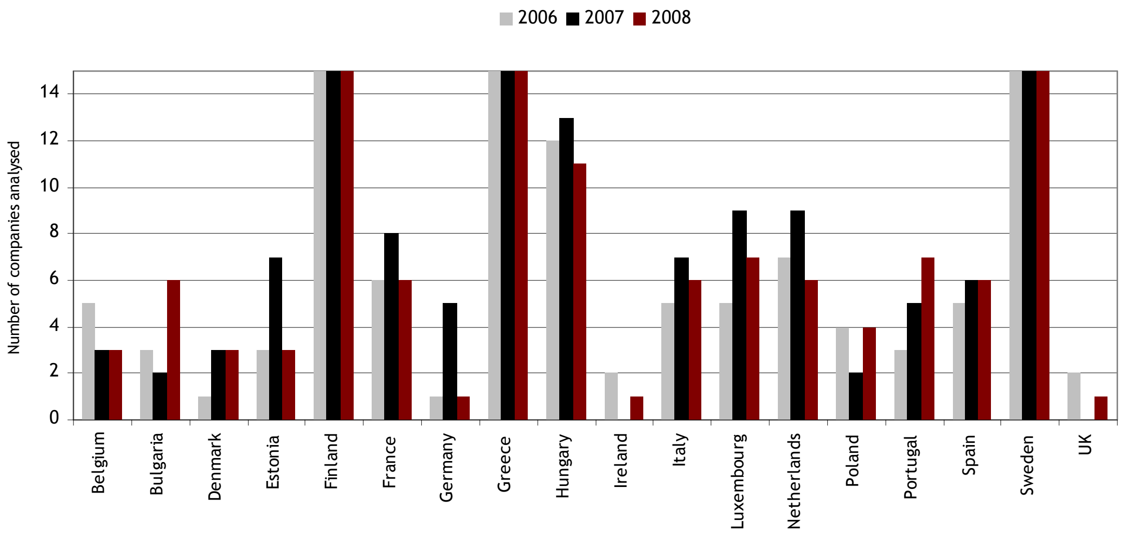


At EU level the number of voting resolutions on companies' remuneration reports/policy increased by 32 percent between 2006 and 2008. In 2006, 15 percent of the companies analysed had the approval of the remuneration report/policy up for a shareholder vote. In 2008, this was getting closer to 25 percent. Among large-cap companies, 29 percent submitted a remuneration report/policy to a shareholder vote in 2008, compared to 21 percent of the mid-cap companies.

There is a clear trend of an increasing number of votes on the issue. However, the proportion of companies where shareholders' opinion on the issue actually is requested is still below one-quarter, even though a European recommendation to vote on companies' remuneration report/policy was published in 2004.

Figure II-5-19: **Vote on (Supervisory) Board Remuneration in EU – per country**

Number of companies featuring votes on (supervisory) board remuneration:



More often than offering a vote on the remuneration report or policy, a company will seek the approval of shareholders for (supervisory) board remuneration. At EU level, shareholders in 68 percent of the companies voted on board remuneration as a separate resolution on the agenda in 2008. As shown above in Figure II-5-19, shareholders in Finland, Greece, and Sweden have voted on remuneration to the board of directors at all companies since 2006. There does not seem to be any particular trend indicating that the number of votes on board of directors' remuneration has increased in the past three years, nor is there any significant difference in the proportion of large-cap companies compared to mid-cap companies that put the item up for shareholder approval.

6 SUMMARY OF FINDINGS

6.1 Comply-or-explain

- Nearly all companies (94 percent of total sample) refer to at least one reference corporate governance document, which is mostly the national corporate governance code.
- One out of five companies refers to a reference corporate governance document, which is not a corporate governance code. These companies refer to foreign listing rules, national corporate governance law or listing rules, or a national law related to their business activities.
- Most companies (86 percent of total sample) disclose comply-or-explain information. This is the case for 92 percent of large-cap companies and 84 percent of mid-cap companies.
- All companies disclose a total of 1,141 explanations of deviations related to the reference corporate governance code they refer to. This comes down to an average of three explanations per company if one excludes Hungary (in which case the average comes down to five explanations per company).
- From all explanations provided, 39 percent are considered sufficiently "informative". They are classified as "specific" information (relating to a specific company situation – 34 percent) or "transitional" information (when companies indicate they will comply in the future – 5 percent).
- Full compliance with the reference corporate governance code is disclosed by 23 percent of companies. Most companies disclosing full compliance do this on a general basis only. Only a handful of companies disclosed full compliance on a provision-per-provision basis.
- Companies disclosing comply-or-explain information on a provision-per-provision basis disclose a significant higher number of explanations on average than companies disclosing this information on a general basis.
- Explanations on deviations of code provisions related to the "board of directors" (or supervisory board) (36 percent of all explanations) and "remuneration" (28 percent of all explanations) make up almost two-thirds of all explanations. The other categories of explanations are related to "shareholder rights and duties" (7 percent of all explanations), "disclosure" (13 percent of all explanations), "audit" (11 percent of all explanations) and "other issues" (6 percent of all explanations).
- Overall, less than half of all explanations (39 percent of all explanations) are qualified as sufficiently "specific" and "transitional". The informative value of explanations in companies disclosing information on a general basis is significantly higher compared to companies disclosing on a provision-per-provision basis.
- The most "informative" explanations are found in France, Sweden, the Netherlands, and the UK. The least "informative" explanations are found in Denmark, Hungary, Portugal, as well as Spain. In the latter three markets most companies disclose comply-or-explain information on a provision-per-provision basis.
- The highest proportion of "informative" explanations is found in the topics on "shareholder rights and duties" and "audit". For both of these categories, 56 percent of all explanations are qualified as "specific" or "transitional".
- The lowest proportion of "informative" explanations are found in the topic on "remuneration". Only 27 percent of all explanations under this category are qualified as "specific" or "transitional".

- Important shareholders are identified in all markets. Two markets have significantly less identified important shareholders, the Netherlands and the UK. Both of these markets are characterized by displaying the most "informative" explanations.

6.2 Board of directors (supervisory board)

- In 2008, on average at EU level, 93 percent of (supervisory) board members were elected by shareholders. A further 5 percent of (supervisory) board members were elected by employees and the remained of (supervisory) board members were elected by the State or other parties.
- In 2008 at EU level, 44 percent of board elections proposed by companies were bundled. Only three markets had fully unbundled elections (France, Ireland and the UK).
- From 2006 to 2008, companies proposing unbundled elections rose from 43 percent to 53 percent.
- 86 percent of companies analysed refer to a definition of independence.
- Of all companies referring to a definition of independence, 86 percent disclose no deviation on the independence definition they refer to, 10 percent disclose one deviation, 3 percent disclose 2 deviations and 1 percent disclose 3 deviations.
- The most common deviation disclosed is related to tenure.

6.3 Audit committees

- At EU level, 81 percent of all companies analysed have set up a separate audit committee and 5 percent have formally attributed the functions of the audit committee to the board of directors (supervisory board). Setting up a separate audit committee is done by 97 percent of large-cap companies and by 75 percent of mid-cap companies.
- The average proportion of independent members on the audit committee amounts to 73 percent for all companies analysed. The average for large-cap companies amounts to 80 percent and for mid-cap companies to 71 percent.
- From all companies with an audit committee, disclosure practices are higher for large-cap companies than for mid-cap companies in all areas (disclosure of meetings, disclosure of responsibilities of audit committees as well as disclosure of charters and activity reports).
- Overall, 75 percent of all companies analysed disclose the aggregate amount of fees paid to the external auditor. For large-cap companies this amounts to 95 percent, for mid-cap companies to 67 percent.

6.4 Remuneration

- At EU level, 77 percent of all companies analysed disclose the existence of at least one variable remuneration component (long-term or short-term). This amounts to 93 percent for large-cap companies and to 71 percent for mid-cap companies.
- 58 percent of companies with variable remuneration disclose the ratio of variable versus fixed remuneration. A significant difference is observed between large-cap companies (71 percent) and mid-cap companies (51 percent).

- At EU level there are mainly three types of variable remuneration disclosed by companies: annual bonus plan (68 percent of all companies disclose the existence of such plan), stock option plans (49 percent of all companies disclose the existence of such plan) and performance share plans (32 percent of all companies disclose the existence of such plan).

- Large-cap companies disclose more information on performance measures than mid-cap companies.

- Companies disclose significantly more information on performance measures for performance share plans than on any other type of variable remuneration component.

- Ex-post information on performance by which companies justify variable remuneration granted to their beneficiaries is largely missing.

- At EU level, 51 percent of all companies analysed disclose information on the severance agreement of executives. This proportion amounts to 72 percent for large-cap companies and to 44 percent for mid-cap companies.

- Severance agreements – if disclosed – are mostly expressed in terms of number of years of fixed remuneration: 62 percent of all companies disclosing information on severance agreements express this as such. Another 20 percent defines it in another way and the remaining 18 percent explicitly indicates that no severance agreement exists.

- Remuneration committees are set up by 88 percent of large-cap companies and by 67 percent of mid-cap companies.

- The average proportion of independent members on the remuneration committee amounts to 62 percent for all companies analysed. The average for large-cap companies amounts to 74 percent and for mid-cap companies to 58 percent.

- In markets where executive remuneration is up for voting, whether this is a non-binding vote on a remuneration report or a binding vote on a remuneration policy, remuneration disclosure standards are higher.

- Overall at EU level, in 2008, 24 percent of all companies analysed submitted their remuneration report or policy to a shareholder vote, with a slightly higher proportion of large-cap companies than mid-cap companies. The proportion amounted to 15 percent in 2006.

CHAPTER III - COMPANY AND DIRECTOR PERCEPTION OF CORPORATE GOVERNANCE CODES

1 INTRODUCTION

Chapter III of this Study measures company and director perception on national corporate governance codes based on 42 responses across 25 EU Member States to a questionnaire[228] circulated to business associations and director institutes and a few other stakeholders (e.g. stock exchanges, associations of listed companies, etc.).

Figure III-1-1 : **Overview of respondents by Member State of origin**

Member State of origin	Response Count
Austria	2
Belgium	2
Bulgaria	2
Cyprus	2
Czech Republic	1
Denmark	1
Estonia	1
Finland	2
France	2
Germany	1
Greece	2
Hungary	1
Ireland	2
Italy	2
Latvia	1
Lithuania	1
Luxembourg	2
Malta	1
Netherlands	1
Poland	2
Portugal	1
Romania	0
Slovakia	0
Slovenia	2
Spain	3
Sweden	2
UK	3
Total	42

[228] See Appendix 3 for the questionnaire.

This chapter also analyses company and director perception on the current monitoring and enforcement practices in the EU. Specifically, this chapter addresses the following issues:

- objectives and effectiveness of corporate governance codes,
- code structure,
- code content,
- legislation and corporate governance codes,
- the comply-or-explain approach,
- costs of compliance with corporate governance codes.

The broad spectrum of business leadership, both non-executive and executive directors, and other stakeholders, as well as the breadth of responses (as mentioned above, 42 responses across 25 EU Member States[229]), allows for a representative assessment of market player opinion on the effectiveness and impact of corporate governance codes across the EU as a whole.

Methodology:

This chapter has been drafted by BUSINESSEUROPE (The Confederation of European Business) and ecoDa (The European Confederation of Directors' Associations), based on a common survey questionnaire developed by GUBERNA (the Belgian Institute of Directors, member of ecoDa) and approved by RiskMetrics[230]. The survey questionnaire was circulated by BUSINESSEUROPE and ecoDa to their networks of national business federations and directors' associations respectively, as well as to other business stakeholders (e.g. stock exchanges, associations of listed companies, etc.).
The responses to the survey of individual associations, reflected in the analysis made by both BUSINESSEUROPE and ecoDa in Chapter III, were based on public consultations, reflection meetings or hearings, public conferences/seminars, research input from a qualified selection of members, or reflect the own opinion of the association itself.
For 15 Member States (Austria, Belgium, Bulgaria, Cyprus, Finland, France, Greece, Ireland, Italy, Luxembourg, Poland, Slovenia, Spain, Sweden, and the UK), more than one respondent has provided responses to the survey. In this case the results presented and analysed reflect the average of their responses. Responses were evaluated on a scale from 1 (most negative result) to 5 (most positive result). The figures have been rounded up in order to represent them in the report in a similar way. Responses from Greece are based not on a corporate governance code but on national law.

[229] See Appendix 2 for all 25 individual country findings.
[230] See Annex 1 for a detailed methodology.

2 EUROPEAN FINDINGS

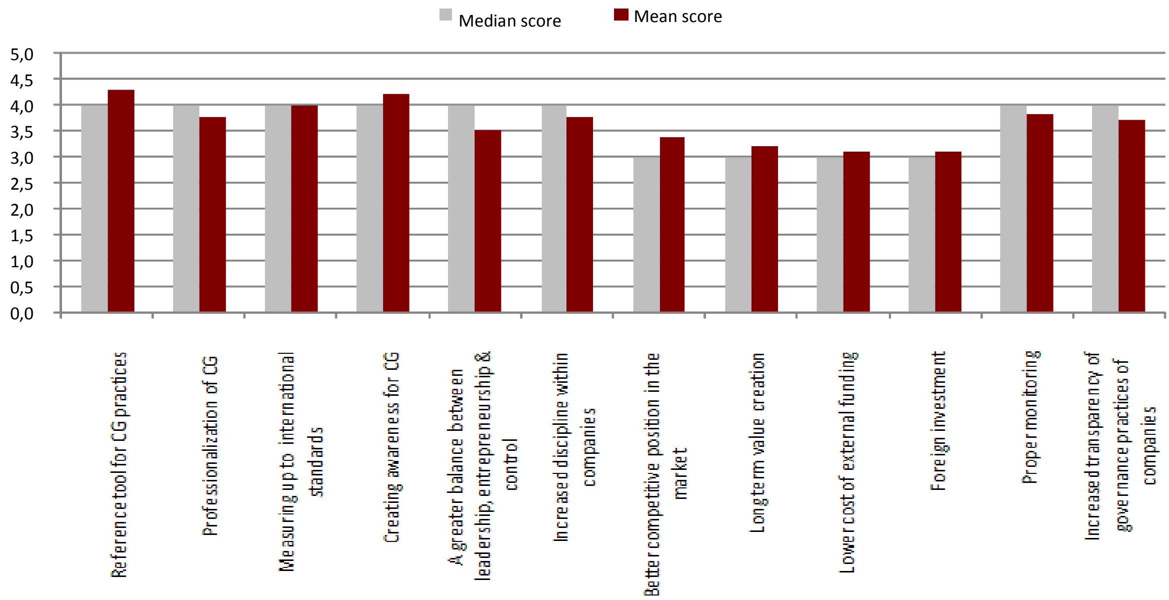
2.1 Objectives and effectiveness of the national corporate governance codes

This section seeks to examine how the initial objectives of the national corporate governance codes ("corporate governance codes"), previously identified by respondents, have been reached and the effects of the corporate governance codes on different topics relating to the board, management, shareholders, and stakeholders. It should be taken into account that some of the organisations which responded to the questionnaires have taken part in the discussions that led to the adoption of the code, or even drafted the code themselves.

2.1.1 Effectiveness of codes in reaching objectives

In this subsection, respondents identified whether or not the 12 subjects listed as basic initial objectives of corporate governance codes were an objective of their national corporate governance code and to what extent these objectives have been reached by the code. The objectives of the corporate governance codes were evaluated on a scale of 1 (not reached) to 5 (completely reached).

Figure III-2-1: **Effectiveness of codes in reaching objectives (European median and mean per objective)**

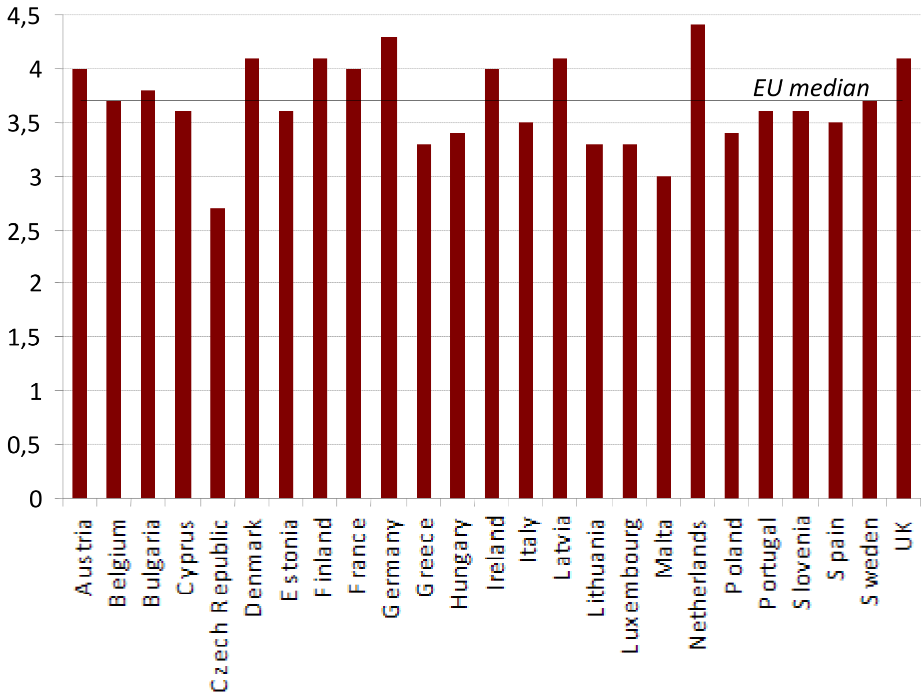


5 = completely reached, 4 = mostly reached, 3 = partially reached, 2 = poorly reached, 1 = not at all reached.

Even if respondents assess the majority of national corporate governance codes as not complete and point out that some objectives, e.g. "lower cost for external funding", are not objectives of some codes, the corporate governance codes appear effective in reaching their initial objectives. Indeed, overall, respondents consider the objectives of the national corporate governance codes as mostly reached.

Only four objectives have been assessed as only partially reached: "better competitive position in market", "long-term value creation", "lower cost of external funding", and "foreign investment", the latter two being assessed as the least reached objectives according to their aggregate mean score (both rated at 3.1 out of 5). The best reached objectives are clearly "a reference tool for corporate governance practices" (4.3 out of 5) and "creating awareness for corporate governance" (4.2 out of five). These findings may be due to the fact that in some Member States, corporate governance codes are a recent addition, and the corporate governance framework is therefore still in a development phase.

Figure III-2-2: **Effectiveness of codes in reaching objectives (European median per country)**



5 = completely reached, 4 = mostly reached, 3 = partially reached, 2 = poorly reached, 1 = not at all reached.

The lowest assessment regarding code effectiveness is made by the respondent from the Czech Republic, where no initial objective of the Czech code has been mostly reached. The assessment made by the respondent from Malta is also very low, except for the following two objectives: “a reference tool for corporate governance practices” and, to a lesser extent, “measuring up to the international standards”, considered ‘completely reached’ and ‘mostly reached’, respectively. The best assessments were made by respondents from Bulgaria, Finland and the United Kingdom (where overall all the objectives were identified and at least mostly reached), and by respondents from Austria, Denmark, France, Germany, Ireland, Latvia, and the Netherlands (although not all objectives were evaluated). These best assessments are slightly above the overall European median. Belgium and Sweden perfectly match the European median score of 3.7 out of 5.

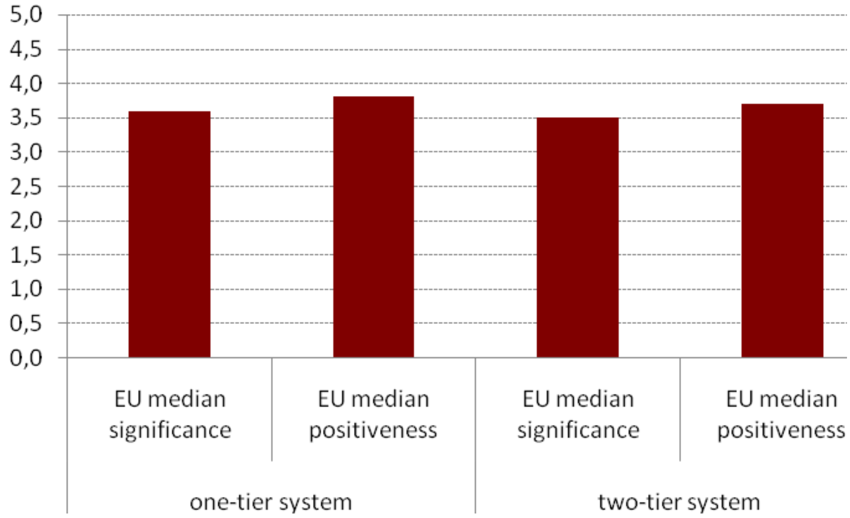
The assessment made by directors (3.5) is only in line with the assessment made by business (3.8). However “a greater balance between leadership, entrepreneurship, and control” is assessed by directors below the business assessment, as only ‘partially reached’. Also, business considers “creating awareness for corporate governance” as ‘completely reached’, while directors find that objectives in this area are only ‘mostly reached’.

2.1.2 Effects of the national corporate governance codes on governance activities

In this subsection, the effects of the corporate governance code were measured for various topics relating to the board. Respondents had to answer these questions in for all types of board structures existing in their Member States (one-tier boards, two-tier boards, or either). Respondents were asked to point out whether the corporate governance code had a significant effect on each of these topics (on a scale of 1-very insignificant to 5-very significant). Furthermore, they were asked if they believed this effect was positive or negative (on a scale from 1-very negative to 5-very positive).

Significance refers to perceived degree of impact, whereas positiveness refers to the extent to which impact is perceived as positive.

Figure III-2-3: **Have national corporate governance codes had a significant effect on the board or supervisory board and has this effect been positive or negative?**



Significance of effect: 5 = very significant, 4 = significant, 3 = neutral, 2 = insignificant, 1 = very insignificant.
Positiveness/negativeness of effect: 5 = very positive, 4 = positive, 3 = neutral, 2 = negative, 1 = very negative.

As far as the one-tier board system is concerned, respondents have assessed the effects of the national corporate governance codes on governance activities as significant and positive overall. No insignificant or negative effect has been observed. Respondents have assessed the effects of the national corporate governance codes as neutral, in terms of positiveness/negativeness, only for three objectives: “addressing the company strategy” (3.3 out of 5), “attention for risk management from the perspective of strategic scenarios and product development” (3.4 out of five), and “director remuneration” (3.4 out of five).

On the basis of their overall European mean scores, respondents judge the most positive effects on governance activities as those relating to the “functioning of the board”, “transparency of decision-making”, “understanding roles and responsibilities of directors”, and “introduction of board committees”, which were all rated at 4.1 out of 5. They are closely followed by “independent directors” and “evaluation of the board”, rated at 4 points out of 5. According to the responses of directors only, corporate governance codes had the most significant effect on “introduction of board committees”.

The lowest rate given by all the respondents concerns “addressing the company strategy”. In terms of countries, the French corporate governance code seems to be the national code with the most positive and significant effects on national governance activities. The most positive effects are also observed in Spain and Italy, when the one tier system is considered. In contrast, the Maltese corporate governance code has the lowest impact.

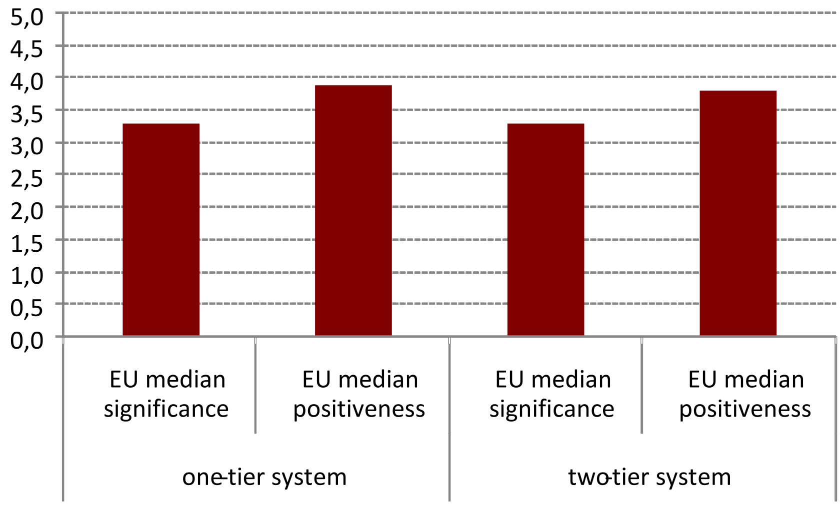
The effects of the corporate governance codes on governance activities for both board systems are assessed as significant and positive. The lowest score (i.e. neutral) common to both one-tier and two-tier systems concerns the “attention for risk management from the perspective of strategic scenarios and product development”. Neutral effects were also assessed, for one-tier systems, for “addressing the company’s strategy”, and for two-tier systems regarding the “competences of directors” and “director remuneration”. According to the responses of directors only, the most positive effect of the corporate governance codes relates to the “introduction of board committees”, for both tier systems. For directors only, the effect of the corporate governance codes is insignificant on “independent directors”, whilst business rates it as neutral. For business "the functioning of the board" was rated as very significant, whereas for the European median it is considered as significant.

Here again, the French corporate governance code was felt to have the most positive and significant effects on national governance activities for the one-tier system, whilst the lowest assessment is made this time by the respondent from the Czech Republic. The most positive effects are also noted in responses from Slovenia, when the two-tier system is concerned.

2.1.3 Effects of the national corporate governance codes on management

In this subsection, the effects of the corporate governance code were measured for different topics relating to management. Respondents had to answer these questions for all types of board structures existing in their Member States (one-tier boards, two-tier boards, or either). Respondents were asked to point out whether the corporate governance code had a significant effect on each of these topics (on a scale of 1-very insignificant to 5-very significant). Furthermore, they were asked if they believed this effect was positive or negative (on a scale from 1-very negative to 5-very positive). Significance refers to perceived degree of impact, whereas positiveness refers to the extent to which impact is perceived as positive.

Figure III-2-4: **Have national corporate governance codes had a significant effect on management and has this effect been positive or negative?**



Significance of effect: 5 = very significant, 4 = significant, 3 = neutral, 2 = insignificant, 1 = very insignificant.
Positiveness/negativeness of effect: 5 = very positive, 4 = positive, 3 = neutral, 2 = negative, 1 = very negative.

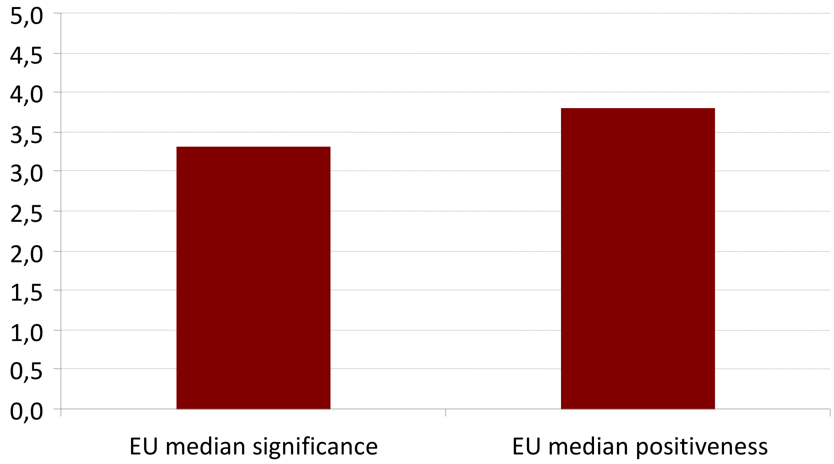
The assessment of the effects of the corporate governance codes on management is considered positive whatever the board structure is. According to the overall mean score across all countries, the most positive effect of the corporate governance codes relates to the "relationship between the board/ supervisory board and the executive management/management board" (respectively 3.9 and 3.8 out of 5), whatever board system is considered.

The French corporate governance code is considered as having positive effects on management, given its relatively higher score when measured against findings for other European countries. Respondents consider the Maltese corporate governance code as having the lowest impact on management compared with the other corporate governance codes based on the one-tier system; the same is true for the Polish corporate governance code when the two-tier system is considered.

2.1.4 Effects of the national corporate governance codes on shareholders

In this subsection, the effects of the corporate governance code were measured for different topics relating to shareholders. Respondents were asked to point out whether the corporate governance code had a significant effect on each of these topics (on a scale of 1-very insignificant to 5-very significant). Furthermore, they were asked if they believed this effect was positive or negative (on a scale from 1-very negative to 5-very positive). Significance refers to perceived degree of impact, whereas positiveness refers to the extent to which impact is perceived as positive.

Figure III-2-5: **Have national corporate governance codes had a significant effect on shareholders and has this effect been positive or negative?**



Significance of effect: 5 = very significant, 4 = significant, 3 = neutral, 2 = insignificant, 1 = very insignificant.
Positiveness/negativeness of effect: 5 = very positive, 4 = positive, 3 = neutral, 2 = negative, 1 = very negative.

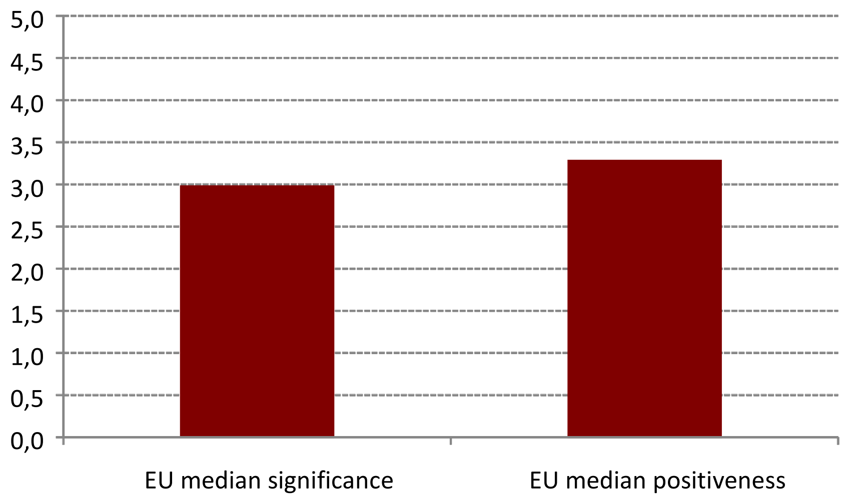
The overall effect of the national corporate governance codes on the topics relating to shareholders is also considered positive with the exception of "awareness of the interests of potential shareholders/financial markets", which respondents assess as neutral. "Increased shareholder trust/confidence of investors" and "communication with shareholders" are the topics where the codes had more significance but also positive effects.

The effects of the Czech code on the topics relating to shareholders are considered rather negative. This assessment constitutes the lowest rate amongst the assessments of the various European countries. On the other hand, very positive effects on topics relating to shareholders are assessed by respondents from Estonia and Slovenia.

2.1.5 Effects of the national corporate governance codes on "awareness of the interests of stakeholders"

In this subsection, the effects of the corporate governance code were measured in relation to its effects on "awareness of the interests of stakeholders". Respondents were asked to point out whether the corporate governance code had a significant effect on each of these topics (on a scale of 1-very insignificant to 5-very significant). Furthermore, they were asked if they believed this effect was positive or negative (on a scale from 1-very negative to 5-very positive). Significance refers to the perceived degree of impact, whereas positiveness refers to the extent to which impact is perceived as positive.

Figure III-2-6: **Have national corporate governance codes had a significant effect on the "awareness of the interests of stakeholders" and has this effect been positive or negative?**



Significance of effect: 5 = very significant, 4 = significant, 3 = neutral, 2 = insignificant, 1 = very insignificant.
Positiveness/negativeness of effect: 5 = very positive, 4 = positive, 3 = neutral, 2 = negative, 1 = very negative.

For 96 percent of the respondents, the assessment of the effect of the national corporate governance codes on "awareness of the interests of stakeholders" is neutral to positive except for results from Latvia, which score significantly below the European median. The effects are assessed as very positive by respondents from Estonia, Malta, and Slovenia (from the time the Slovenian code started the corporate social responsibility and stakeholder debate).

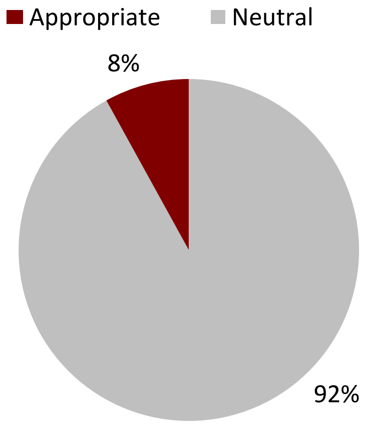
2.2 Structure of the codes

This section aims to analyse the overall assessment of the adequacy and clarity of the corporate governance code recommendations.

2.2.1 Adequacy of the overall structure of the national corporate governance codes

The adequacy of the overall structure of the corporate governance codes was evaluated by respondents on a scale from 1 (inadequate) to 5 (adequate).

Figure III-2-7: **Overall structure of the code**



The overall structure of the different national corporate governance codes is considered good, with 92 percent of the respondents assessing the structure of their codes as adequate, meaning that for 23 countries, respondents have rated the clarity between 4 and 5 out of 5. There are two exceptions: respondents from the Czech Republic and Denmark assess their codes' structure as neutral (3) below the European median which is 4 out of 5.

2.2.2 Clarity of the recommendations

Respondents evaluated the clarity of the corporate governance code recommendations on a scale from 1 (not clear at all) to 5 (very clear).

The different national codes are clear in their recommendations for the majority (84 percent) of the respondents. Indeed, for 21 countries, respondents have rated the clarity of the corporate governance code between 4 or 5 out of 5. In only four countries - Czech Republic, Denmark, Malta, and Portugal - is the assessment by respondents neutral (3), below the European median, which is 4 out of 5.

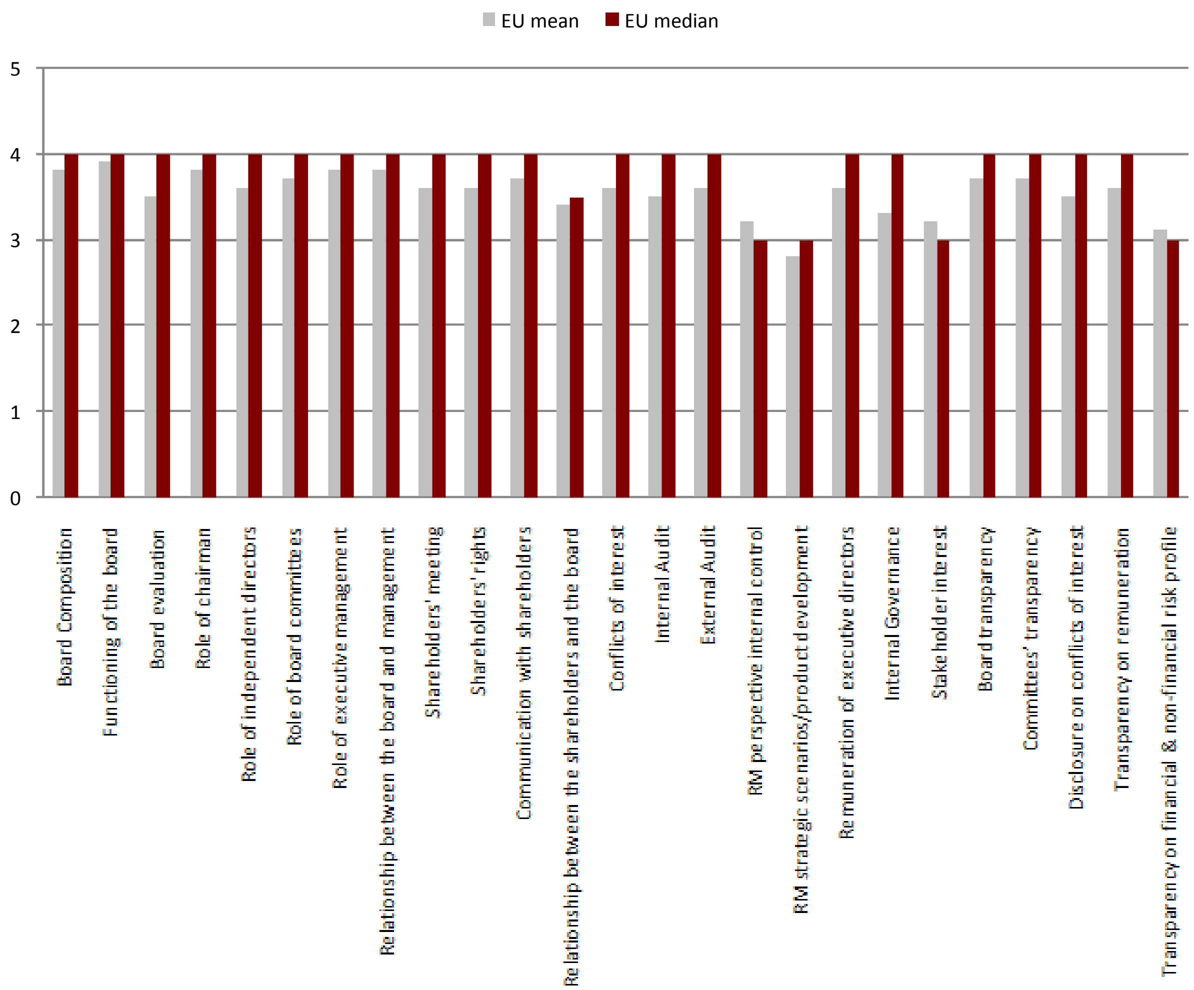
2.3 Content of the codes

This section aims to assess the completeness of the corporate governance codes in dealing with appropriate topics. In addition to an overall assessment of the code's content, rated on a scale of 1 (totally disagrees) to 5 (totally agrees), respondents were asked about the degree of completeness for twenty-five issues which are dealt with in most national codes. The scale used is from 1 (missing and should be treated) to 5 (too detailed).

Overall, the majority of respondents find that the national corporate governance code in question deals with the appropriate topics. Respondents from Hungary and Slovenia perceive the content of the code as very positive (rating 5 out of 5, above the overall European median, which is 4). Only respondents from the Czech Republic and Malta consider the appropriateness of the topics dealt with by the code as neutral (3 out of 5).

Other subjects not presented in the questionnaire, but which were identified by certain respondents as potentially leading to an improvement of the content of the codes, include the following: the relationship between board of directors and shareholders, especially at General Meetings which could motivate attendance of smaller shareholders, the involvement of the board of directors in the company strategy, and corporate social responsibility.

Figure III-2-8: **Content of the codes**



5 = too detailed, 4 = well-treated, 3 = needs refinement, 2 = not sufficiently treated, 1= missing and should be treated.

Overall, the level of detail of the national corporate governance codes is considered adequate. All the topics have been assessed as well-treated, except “risk management from the perspective of internal control”, “risk management from the perspective of strategic scenarios and product development” and “stakeholder interests,” which need overall refinement and are rated below the overall European median response on these issues.

The aggregate European scores suggest that the most well-treated topic in the corporate governance codes is “functioning of the board”, followed by the “role of executive management”, “board composition” and the “role of chairman”. The least well-treated topics overall are “risk management from the perspective of strategic scenarios and product development” and “transparency on financial and non-financial risk profile”.

In the Netherlands, all topics identified and dealt with in the code have been assessed as well-treated and are scored above the overall median. Respondents from Cyprus, Denmark, Germany, the UK, and Latvia also consider the items as well-treated overall and also rate them above the European median.

The lowest assessment was made by respondents from Malta, Poland, Lithuania, and the Czech Republic where, overall, several topics are not sufficiently treated in the code.

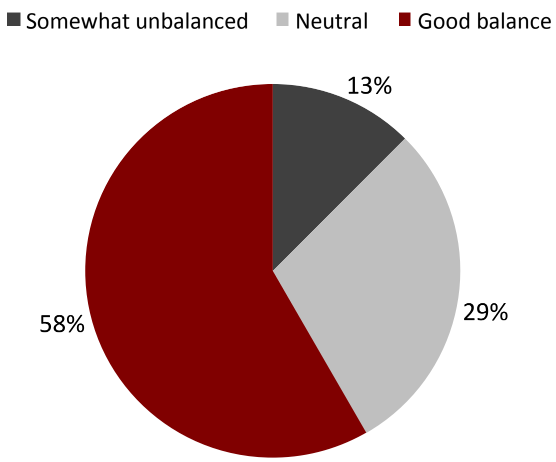
Overall, matters identified as not needing coverage in corporate governance codes are "risk management from the perspective of strategic scenarios and product development" and "internal governance".

Issues mostly pointed out as already being dealt with in regulation are "shareholder rights", "risk management from the perspective of strategic scenarios and product development", "stakeholder interest" and "transparency on financial and non-financial risk profile".

2.4 Legislation and corporate governance codes

This section aims to assess respondents' perception on the complementarities between legislation and the corporate governance codes. It seeks to analyse if the relation between the corporate governance codes and legislation is balanced. The balance between hard law and soft law at national level was evaluated by respondents on a scale from 1 (not in balance at all) to 5 (very good balance).

Figure III 2-9: **Balance between hard law and soft law**



Responses from 24 countries231 suggest that the majority (overall assessment for 14 countries) find that hard law and soft law are balanced in their Member States, meaning that they score above or match the European median score of 3.5 points (out of 5) overall. In the Czech Republic, Estonia, and Malta hard law and soft law are assessed as being somewhat out of balance[232], below the overall European median score. In Belgium, Bulgaria, Ireland, Italy, Latvia, Poland, and Slovenia the balance is considered neutral (respondents consider the balance to be neither very good nor bad), even if in Belgium the business community underlines that the balance reached is 'good'.

In some countries, respondents have noted that corporate governance is highly regulated, interferes with the self-regulation process, and leads companies to face rather constricting and detailed regulation, e.g. Italy, although there is room for improvement on the national corporate governance code on issues related to shareholders, e.g. France. In the UK, an appropriate balance has proved conducive to both wealth creation and high corporate governance standards. A shift towards a more hard-law-oriented approach would be viewed negatively by most UK companies (although there is recognition of the need for an improved regulatory regime in the financial sector). In other countries, corporate governance topics are also dealt with by legislation. Recent enactment of legislation in the wake of the financial crisis has also been noted, e.g. Slovenia. Some respondents also point out that the legislator should take corporate governance codes more seriously since they encourage companies to comply with effective corporate governance principles.

Some respondents pointed out that there is legislative appetite for most corporate governance issues. Market players have observed an increase in legislation at the EU and national level during recent years. It is considered by some respondents that soft law is the best way to proceed regarding corporate governance since it provides both the adequate framework and necessary

[231] No response from Hungary was received to this question.
[232] When responding to this specific point, respondents did not further specify the reasons why they considered that hard law and soft law were somewhat unbalanced in their country.

flexibility that is needed for companies to pursue their business and allows the corporate governance principles to be applied as the outcome of a dialogue between boards and shareholders. However, it is important that self-regulation does not interfere with the principle of division of responsibilities laid down in company law. It is pointed out by one respondent that the national corporate governance codes should be limited to issues not yet covered under legislation and by another that it may have a scope of interpretation of hard law.

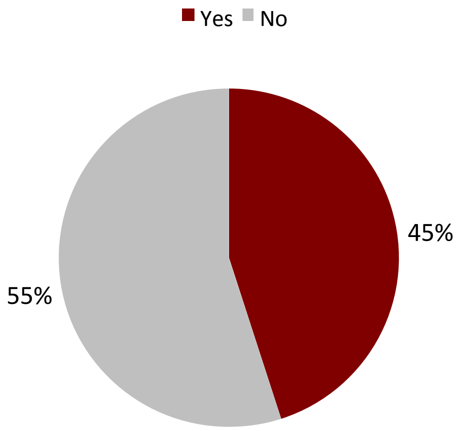
Different opinions can be found amongst respondents on which topics are better dealt with by hard or soft law. These different opinions are particularly noted regarding disclosure on conflicts of interests, corporate social responsibility, aspects of board member remuneration, , external and internal audit, internal governance, and board functioning and composition.

Amongst the subjects identified by respondents that could be better dealt with under legislation are all duties enforced by or entailing sanctions, liability of directors, corporate transparency (e.g. reporting and disclosure requirements), notice periods, the definition of independent directors, director rights and responsibilities, fundamental rights, creditor rights, and stakeholder issues. Directors in particular highlighted shareholder issues, e.g. shareholder meetings or shareholder property. Also, the 'put up or shut up' rule - giving a bidder (or prospective bidder) the choice in the case of takeover speculation of announcing within a given period either that it intends to make a bid or that it has decided against doing so. In the latter case, the concerned party should not be able to make any further bid for the company for a considerable period of time. One respondent also points out a 'response time' of 180 days for situations in which a company is confronted with a shareholder who wishes to bring about a change of strategy. These considerations vary broadly amongst respondents.

General principles of corporate governance and ethical concepts, retail investor protection, board members contracts, limitation on number of board member mandates, complaint and arbitration procedures are amongst the topics that respondents consider should be dealt with through self-regulation.

10 out of 42 (24 percent) of respondents acknowledge that the corporate governance code goes beyond, fills in the gaps within, and explains what is in the legal provisions. 21 percent consider that the code fills in the gaps within and goes beyond the legal provisions. 19 percent of the respondents consider that the corporate governance code goes further than the legal provisions. Only one respondent considers that the corporate governance code simply explains what is in the legal provisions, and five believe that the corporate governance code explains what is in the legal provisions and goes beyond them.

Figure III-2-10: **Has the Code prevented the adoption of legislation within your country?**

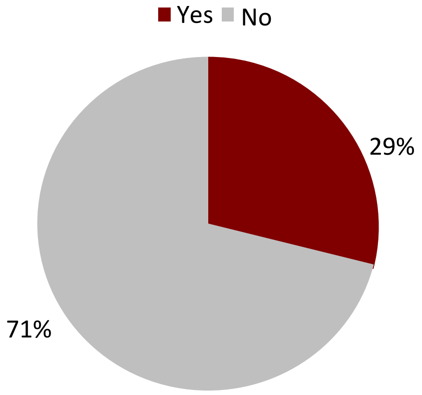


A slight majority of respondents acknowledge that the corporate governance code has not prevented adoption of legislation at the national level[233], although in some countries opinions are divided. Consensus that the code has prevented the adoption of legislation exists amongst respondents from France, Finland, Belgium, Greece, and the UK, which is assessed by the majority as positive or very positive. Also, respondents from Portugal and the Netherlands consider on a positive note that the code has prevented the adoption of legislation. Topics identified as not being legislated include: the safe assessment of a company, internal audit, remuneration and severance pay, diversity of board members, corporate social responsibility, independent directors, behaviour of shareholders at General Meetings, disclosure of certain categories of information, internal audit, primary functions of the board of directors, and conflicts

[233] Number of responses considered: 38 out of 42.

of interest. Respondents from Slovenia, Italy, Sweden, Germany, the Czech Republic, Hungary, Lithuania, Latvia, and Malta believe that the code has not prevented the adoption of legislation.

Figure III-2-11: **Has the Code brought about legislation within your country?**



The majority (71 percent) of respondents[234] believe that the code has not prompted new legislative proposals at the national level. However, legislation was adopted in Austria, Portugal, Belgium, France, Greece[235], Italy, Cyprus, Poland, Slovenia, Italy, and the UK. Directors from Poland, Slovenia, Italy, and the UK as well as from the Cyprus Stock Exchange have assessed this point as positive. Respondents from Austria and Portugal consider it negative, whereas respondents from France, Italy, Greece, and Belgium consider it neutral. Legislation introduced mainly concerns board size , number of board memberships, more extensive disclosure requirements on director remuneration, rules making supervision of corporate governance code application mandatory, the presence of independent directors, slate voting for all listed companies in Italy, internal audit and implementation of audit committees, financial information, independent directors, annual corporate governance statement, etc. In Belgium, there are currently proposals before the Parliament to introduce a reference code (implementation of European Directive 2006/46) and other proposals to integrate remuneration committees.

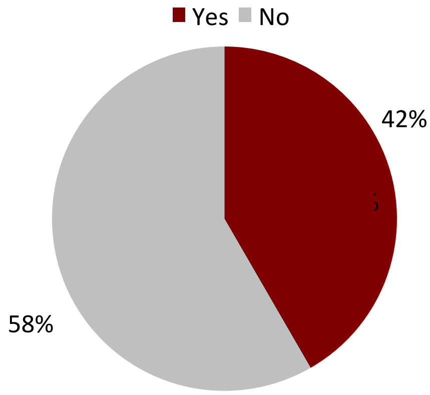
The majority of respondents[236] consider that the code can have important consequences for court judgments (as an interpretation reference (68 percent), as a direct legal basis (10 percent) or as both (8 percent). A minority of respondents (15 percent) from the UK, Latvia, Greece, Finland, Poland, and the Czech Republic do not recognise any effect of the code on court judgments.

A number of legal cases from the Netherlands[237], Italy[238], Germany[239], and Ireland[240] illustrate the previous assessment.

A total of 20 respondents (48 percent)[241] consider that diversity of listed companies is sufficiently (4 or 5 out of 5) taken into consideration by the code. 29 percent consider that the extent to which codes take company diversity into account is neutral (3 out of 5). However, respondents from Malta, Bulgaria, Denmark, Spain, Italy, and France consider that it is not sufficiently (2 out of 5) taken into account, scoring less than the European median, which is 3 out of 5.

[234] Number of responses considered: 38 out of 42. The fact that the corporate governance code brought about new legislation was evaluated by the respondents on a scale of 1 (very negative) to 5 (very positive).
[235] It should be noted that in Greece legislation on Corporate Governance is in force and that the assessment by respondents was done in relation to the law.
[236] Number of responses considered: 40 out of 42.
[237] Stork case - 17 January 2007 (LJN: AZ6440, Gerechtshof Amsterdam, 15/2007); ABN AMRO case – 13 July 2007 (LJN: BA7971, Hoge Raad, R07/101HR).
[238] 7 Consiglio di Stato, the Italian admnistrative court of appeal on 12 February 2007 (No.550).
[239] 7 U 5628/07 delivered by OLG München on 6 June 2008 and II ZR 185/07delivered by BGH on 16 February 2009.
[240] *Dunnes Store Ireland Co. Ltd.-v- Ryan & Anor*, Supreme Court of Ireland, 280 & 291/00,1 February 2002.
[241] Number of responses considered: 42 out of 42.

Figure III-2-12: **Should codes be aligned at the EU level?**



The majority of respondents[242] do not see a need to align corporate governance codes at the EU level. However a minority, mainly from Eastern and Southern European countries, consider that there is such a need. Respondents from Spain and Greece are the only countries from the EU-15 calling for an alignment of corporate governance codes at the EU level. Also, respondents from Bulgaria and Malta call for alignment of corporate governance codes. Finally, one respondent considers that such alignment depends on the method since, in his opinion, there is no need for mandatory harmonisation measures at EU level.

2.5 The comply-or-explain approach

This section aims to analyse different questions relating to the flexibility of the comply-or-explain principle and its consequences.

Almost all the corporate governance codes (22) are based on the comply-or-explain principle except for two of them: the Czech corporate governance code and the Lithuanian code (in Greece, the comply-or-explain principle does not apply either as there is no code, but a Law on Corporate Governance) instead.

According to 83 percent of the respondents[243], the comply-or-explain principle offers companies sufficient flexibility to implement an appropriate corporate governance structure. Even where the flexibility provided is rated as not sufficient, respondents from Malta, Latvia and, Portugal state that the comply-or-explain principle offers more flexibility than regulation. For Ireland, Poland, and Sweden, no agreement amongst the respondents has been found on this question.

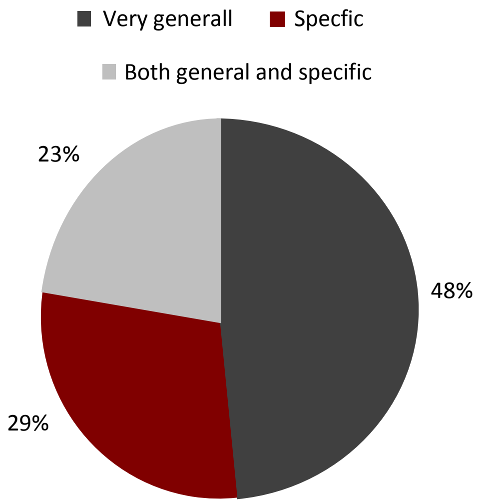
The majority of respondents[244] (84 percent) to the questionnaire consider that the comply-or-explain principle takes into account the specific situation of a company, except for some respondents from Hungary, Malta and Spain which consider otherwise. In Italy, the respondents do not agree on this question.

Following the assessment of the respondents[245], there is no clear tendency in Europe for companies to attempt to comply with the principles of the corporate governance code when this is not suitable for them. However, responses are somewhat divergent for most of the countries. Only in Luxembourg, France, Hungary, the Netherlands, and Malta is there a clear statement from respondents that there is no such tendency.

Regarding the willingness of shareholders to accept explanations, 95 percent of respondents believe they are willing to accept explanations for deviations from the corporate governance code[246]. Only the director representatives in Poland state that shareholders are not willing to accept explanations.

[242] Number of responses considered: 36 out of 42.
[243] Number of responses considered: 35 out of 42.
[244] Number of responses considered: 32 out of 42
[245] Number of responses considered: 29 out of 42.
[246] Number of responses considered: 22 out of 42.

Figure III-2-13: **Content of explanations for deviations from corporate governance codes**



The explanations for deviations from the corporate governance codes are mostly perceived as being very general[247]. However, there is a perception from respondents in Austria, Ireland, and Portugal that explanations are specific. In the UK and the Netherlands, respondents consider that the explanations can be considered as both general and specific, depending on a given case. 89 percent of the respondents stating that explanations in their country are specific represent business.

Regarding the quality of the explanations, even if most of the European respondents consider that they are of 'good' quality, the responses are very heterogeneous. Moreover, respondents from a single country often have divergent opinions. The corporate governance codes do not always provide guidance on what an adequate explanation should contain. The explanations provided by companies in Hungary are considered as unhelpful in all cases.

The influence of controlling shareholders on the effectiveness of the comply-or-explain system is perceived as neutral (3 out of 5 in line with the European median, which is 3) in 62 percent of the countries for which there is a response[248]. Respondents assess the influence of controlling shareholders as rather negative (2 out of 5) in Cyprus, Malta, and Slovenia, while they consider its influence positive, in Austria, Finland, Ireland, and Sweden, where scores were above the European median. In Slovenia, one of the respondents considers that most corporate governance problems are related in some way to controlling shareholders.

2.6 Costs of compliance with corporate governance codes

This section aims to assess the costs of compliance with the corporate governance code in relation to the benefits achieved. When analysing the impact of the corporate governance principles on SMEs, reference is made to small and medium *listed* companies.

The majority of respondents consider that the benefits of implementing the corporate governance code exceed the costs. It is pointed out by one respondent that implementation of the corporate governance recommendations creates trust, which is very valuable.

A total of 41 percent of respondents[249] consider that the costs of implementation of the corporate governance recommendations remain too high for SMEs. The needs of human resources and the fact that the codes are not always tailored to meet the needs of smaller listed or unlisted companies, even if some concessions have been made for smaller companies in certain areas, e.g. in the UK, boardroom committees and significant numbers of non-executive directors may lead to costly and unnecessary requirements (relative to the benefits) for these types of companies. Two respondents considered that the costs are commensurate to the advantages.

Only one respondent, from Greece, has pointed out that costs of applying the corporate governance law exceed the benefits of transparency due to the increased administrative burdens for both large and medium-sized companies.

[247] Number of responses considered: 31 out of 42.
[248] Number of responses considered: 21 out of 42.
[249] Number of responses considered: 37 out of 42.

The majority of respondents[250] (58 percent) consider that the benefits of transparency outweigh costs of disclosure, and a total of 39 percent consider that the costs of disclosure are too high for SMEs. Respondents point out that the benefits of transparency are not appropriately balanced with respect to the details required for SMEs. Only one respondent, from Latvia, considers that the benefits of transparency do not outweigh the costs of disclosure.

[250] Number of responses considered: 38 out of 42.

3 COUNTRY-SPECIFIC OBSERVATIONS

Austria

The Austrian corporate governance code was drafted by the Austrian Working Group on Corporate Governance, and has been in force since October 1st, 2002. Since January 1st, 2009 a third revised version of the Code has entered into force. The overall appraisal of the code regarding its effectiveness is in line with or above the European median. The majority of the topics are well-treated. Respondents consider the comply-or-explain principle to have a positive effect on company governance, in so much as it takes into account specific situations, offers sufficient flexibility for companies to implement the suitable corporate governance structure, and provides specific, satisfactory, if not highly satisfactory, explanations. The overall structure of the Austrian corporate governance code is adequate, and its recommendations are clearly formulated. Austria is one of the countries where the influence of controlling shareholders over the effectiveness of the comply-or-explain system is positive. There could be support for a European corporate governance code provided that an appropriate methodology could be found, since there is no need for mandatory harmonisation measures at the EU level.

Belgium

The Belgian corporate governance code was drafted by the Belgian Corporate Governance Committee and revised in March 2009. The assessment of the Belgian code is satisfactory and similar to the European median score. However, the negative effects of the Belgian code on “increased shareholders trust” and “communication with shareholders” is clearly below the median of all EU countries. Respondents find that the Belgian code generally deals with the appropriate topics and seems to be relatively complete. Most of the topics are well-treated except, again, for the topics related to shareholders and stakeholders. In addition, the issue of “internal governance” needs refinement in the Belgian context.

Bulgaria

The Bulgarian corporate governance code was issued in October 2007 by the Bulgarian Stock Exchange. The Bulgarian corporate governance code was officially introduced only one year and several months ago. It includes all important issues which, in the view of the respondents, should be dealt with, but the numerous binding legal provisions to some extent prevent the possibility of seeing the real effect of the code's recommendations. More time is needed to assess its influence on companies, their boards, controlling shareholders, stakeholders, and the country’s investment community as a whole. This observation explains why there is occasional divergence amongst respondents. However, on the whole, the assessment of the Bulgarian corporate governance code is rather neutral or positive. The effectiveness of the Bulgarian code in reaching the initial objectives is largely assessed in line with the European median score, and most of the objectives are partially or mostly reached. Respondents find that the corporate governance code comply-or-explain principle seems to work effectively and that explanations for deviations from the corporate governance code are sufficient. In addition, there is a clear demand for a European corporate governance code.

Cyprus

The Cyprus Stock Exchange (CSE) corporate governance code has been in force since September 2002, with a second edition dating back to March 2006. On the whole, the assessment of the code in terms of effectiveness is strong, in line with the European median. The code is adequate and its recommendations clearly formulated. It has a very significant and positive effect in particular on stakeholders. Respondents noted the code has had a very significant and very positive effect on “increased shareholder trust/confidence of investors”. Full implementation based on the comply-or-explain principles is mandatory for companies listed in the main market. The comply-or-explain principle allows sufficient flexibility for companies, but there is room for improvement in the quality of explanations given to shareholders. Respondents consider the influence of controlling shareholders over the effectiveness of the comply-or-explain system as negative. Divergence amongst respondents was regularly noted in this market.

Czech Republic

The Czech corporate governance code is based on the OECD principles and was issued in 2004 by the Czech Securities Commission. Respondents did not assess the Czech code favourably. Instead, this country had scores below the European median, except where stakeholder interests are concerned. With some of the objectives not adequately attained, the assessment of the Czech code's effectiveness in reaching the initial objectives is below the European median score and also below the European median score for directors only. The effects of the Czech code on the topics related to management are positively assessed and better assessed than those related to governance activities. According to the respondent, the Czech code needs revision and amendment in accordance with European standards since many corporate governance topics are not even mentioned. At present, the Czech code is not based on the comply-or-explain principle, unlike most of the corporate governance codes.

Denmark

On August 15th, 2005, the Committee on Corporate Governance issued its Recommendations for Corporate Governance; its section VI was revised on February 6th, 2008; sections III and V were later revised on December 10th, 2008. On the whole, the assessment of the code in terms of effectiveness of the initial objectives reached is positive, slightly above the European median. Respondents consider that the code does not take into account the diversity of companies sufficiently. Most of the initial objectives of the Danish recommendations have been completely or mostly reached. The comply-or-explain principle offers sufficient flexibility for companies to implement the right corporate governance structure. Although the code generally deals with the appropriate topics, the respondent takes a neutral stance on whether the overall structure of the code is adequate.

Estonia

The corporate governance code published by the Tallinn Stock Exchange and the Estonian Financial Supervision Authority, has been in force since 2006. On the whole, the assessment of the code in terms of effectiveness is positive, in line with the European median. Most of the initial objectives of the Estonian corporate governance code have been partially or mostly reached. The code had a positive and significant effect on the majority of the topics listed in the questionnaire, and its overall assessment is in line with the European median. In particular, respondents rate the effect on shareholders and stakeholders as very significant and very positive, and these areas attain one of the highest scores relative to the European median. Although the overall structure of the Estonian code is highly adequate, no proper balance between hard law and soft law has been reached in Estonia. The explanations for deviations from the Estonian code are perceived as good but very general.

Finland

The Finnish corporate governance code has been in force since July 1st, 2004. A revised version has been in force since January 1st, 2009 and was published by the Securities Market Association. On the whole, the assessment of the code in terms of effectiveness is positive, and in general, the effects of the code are often above the European median. There is strong agreement amongst the respondents that most of the initial objectives of the Finnish corporate governance code have been mostly or completely reached. Respondents consider the overall effect of the code on stakeholders and on shareholders as neutral. Overall, the code generally deals with the appropriate topics. The overall results are in line with the European median, although the assessment made by directors only is generally more positive than the assessment by business respondents.

France

The corporate governance code of listed corporations (AFEP/MEDEF Code) has been in force since December 2008 – initially consolidated in 2003, supplemented and re-consolidated in December 2008. On the whole, the assessment of the code in terms of effectiveness is positive and above the European median score. The evaluation made by business is often marginally higher than the evaluation of individual directors. The effects of the code on governance activities and on management are viewed as particularly positive. Respondents in France rate its effects above the European median whatever the board system in question. One of the respondents believes that the code should pay more attention to some specific issues, in particular to issues related to shareholders and to risk management, and regrets that the existence of lead directors is not widespread. Although directors consider that there is a need to align various corporate governance codes at the EU level, this view is not shared by business.

Germany

The German corporate governance Kodex drawn up by the Government Commission on Corporate Governance Code was adopted on February 26th, 2002. On the whole, the assessment of the code in terms of effectiveness in reaching its initial objectives is good, slightly above the European median score. It allows sufficient flexibility for companies to operate, and the code sets out recommendations which are well-adhered to by companies. Respondents view that the extent to which German code recommendations take the diversity amongst listed companies into account is neutral. The code can have important consequences for court judgements as an interpretation reference. Two cases[251] serve as evidence of this fact. One instance concerns the reversibility of approval in the case of a wrong declaration on the corporate governance code, and the other relates to a resolution from the general meeting that deviated from an accepted corporate governance code recommendation and triggered an amendment to the declaration on the corporate governance code.

Greece

In Greece, reference is made to the Corporate Governance Law 3016/2002, since there is no reference code as such. However the respondents were asked the same questions as for the other countries. On the whole, the assessment of the law in terms of effectiveness is positive. This observation is despite the fact that the median score for the legal framework's attainment of objectives is slightly below the overall European median score. The effect of the Greek law on shareholders is significant and positive. Since it is law, business considers that companies are given insufficient flexibility. The influence of controlling shareholders over the effectiveness of the system is assessed as negative. The existing framework in Greece, especially after implementation of Law 3556/2007, which enhanced transparency and information of listed companies, satisfactorily covers most fields of corporate governance. Beyond a company's obligation to comply with legal provisions fully, a Greek listed company may also chose to self-commit and adhere to stricter corporate governance rules and regulations.

Hungary

The Budapest Stock Exchange's Corporate Governance Recommendations were introduced in 2004 and revised in 2008. On the whole, the assessment of the Hungarian code is slightly below the European median score, particularly regarding the content of the code, where some issues are not sufficiently treated. . In addition, the corporate governance code's comply-or-explain principle lacks real impact, and the quality of explanations is very poor and very general. Furthermore, the comply-or-explain principle does not take into account the specific situation of a company. As full compliance with the comply-or-explain principle was required only as of May 2008, market reactions are still emerging. Respondents report that the corporate governance code provides no guidance on what an adequate explanation should contain and suggest that the explanations companies provide are unhelpful in all instances.

Ireland

Irish companies report according to the UK Combined Code on Corporate Governance (and associate guidance: the Turnbull Guidance, the FRC Guidance on Audit Committees and the Higgs Report). It was first published by the UK Financial Reporting Council in 1998 in the wake of previous initiatives like the Cadbury Report of 1992 and the Greenbury Report of 1995. On the whole, the assessment of

[251] 7 U 5628/07 delivered by OLG München and II ZR 185/07delivered by BGH.

the Irish code is positive and, in terms of effectiveness of its initial objectives, is slightly above the European median score. The results are more or less in line with the European median scores. However, the assessment differs slightly from the other countries for specific questions, e.g. the quality and the content of explanations for deviations from corporate governance code, assessed by Irish respondents as good and specific. The Combined code had an overall significant and positive impact for all governance activities except for "director remuneration". Disagreement amongst the respondents was occasionally registered, particularly when they are asked to state whether there is an appropriate balance between hard law and soft law.

Italy

In Italy, reference is made to the *Codice di Autodisciplina*, issued by the Milan Stock Exchange, (first published in 1999 and revised in 2002 and 2006). On the whole, the assessment of the code in terms of effectiveness is in line with the European median. Respondents have highlighted that the excessive amount of legislation in Italy, which does not leave sufficient space for self-regulation and may not take into account the specific needs of companies sufficiently. . "Board evaluation" is considered as needing refinement. The corporate governance code has not prevented legislation from being adopted: for instance, legislation was adopted to make supervision of corporate governance code application mandatory, and to introduce the presence of independent directors, as well as slate voting for all listed companies.

Latvia

The Corporate Governance principles and recommendations on their implementation, from the Riga Stock and Exchange Commission, have applied in Latvia since December 27th, 2005. On the whole, the assessment of the code in terms of effectiveness in reaching its initial objectives is positive, slightly above the European median score. The code deals mostly with the appropriate topics which are mostly well-treated. The overall assessment of the code is positive, although its effect on stakeholders is considered negative but significant. The influence of controlling shareholders is above the European median score. The flexibility of the comply-or-explain principle is not sufficient, even though it is better than regulation. Furthermore, respondents consider that the extent to which Latvian recommendations take diversity at listed companies into account is neutral.

Lithuania

In Lithuania, the corporate governance code of NASDAQ OMX has been the code of reference since 2004. On the whole, the assessment of the code in terms of effectiveness in reaching its initial objectives is slightly below the European median assessment, but the respondent considers that the resulting transparency benefits are very positive. The respondent stressed in particular that communication with stakeholders should be improved. The corporate governance code covers the appropriate topics. The Lithuanian corporate governance code is not based on the comply-or-explain principle.

Luxembourg

In Luxembourg, the ten principles of corporate governance of the Luxembourg Stock Exchange have been in force since 2007. On the whole, the assessment of the code in terms of effectiveness is in line the European median score. The evaluation made by the directors is only slightly higher than for business respondents. There is clearly no tendency for companies to attempt to comply with the principles of the corporate governance code in Luxembourg when not suitable for companies. The explanations given to shareholders for deviating from the code are either specific or very general, but perceived as good.

Malta

In Malta, the Malta Stock Exchange published the Code of Principles of Good Corporate Governance on June 18th, 2001. On the whole, the assessment of the code of Principles of Good Corporate Governance is clearly below the European median score, if not the lowest score for some questions. The effectiveness of the code of Principles of Good Corporate Governance in reaching the initial objectives is assessed below the European median score, and most of the issues are considered as only partially reached. Only where "communication with shareholders" and "awareness of the interests of stakeholders" are concerned is the assessment of the code higher than the European median. The level of details in the code regarding "role of chairman" is considered very poor, unlike the European median score. The diversity between listed companies is clearly insufficiently taken into consideration in the Maltese recommendations, and the comply-or-explain principle does not take into account the specific situation of a company. The respondent refers to other national codes to improve the content of the Maltese code and calls for alignment of the corporate governance codes at EU level.

The Netherlands

The Dutch corporate governance code was drafted by the Corporate Governance Committee chaired by Mr Morris Tabaksblat and has been in force since 2003 (responses to the questionnaire were provided based on this version). The Code was revised in December 2008 by the Dutch Corporate Governance Code Monitoring Committee. On the whole, the assessment of the code in terms of effectiveness in reaching its initial objectives is positive, slightly above the European median score. The overall structure of the code is highly adequate, and it deals with the appropriate issues. All issues which need to be covered by the code are well-treated. This homogeneous assessment is above the European median rating. There is no tendency for companies to attempt to comply with the principles of the corporate governance code when it is not suitable for companies. Shareholders are willing to accept explanations on deviations from the corporate governance code. The explanations given for departure from the corporate governance code are both specific and very general, and perceived as very good.

Poland

The Best Practices for Companies Listed at Warsaw Stock Exchange came into force in January 2008 and replaced the Best Practices for Public Companies issued in June 2002. On the whole, the assessment of the Polish corporate governance code is below the European median score. This finding is particularly true 1- when the quality of explanations for deviations from corporate governance code is concerned (i.e. very poor and general), 2- when the respondents state that shareholders are not willing to accept the explanations for deviations from corporate governance code, and 3- when the effect of the Polish code on "director remuneration" is assessed (i.e. very insignificant and negative). The responses to all these questions are significantly below the European median, presenting the lowest score on these topics. Many issues are not sufficiently treated in the Polish corporate governance code, which should be reviewed in order to strengthen independent members of supervisory board and director responsibility for company activities and performance, even if the code has been in force only for 14 months. In addition, one of the respondents points out that external factors still influence Polish corporate governance. Finally, there is no agreement amongst respondents on the need to align the corporate governance codes at European level.

Portugal

In Portugal the CMVM (Comissão Nacional de Valores Mobiliários, the Portuguese Securities Market Commission) corporate governance code dates back to September 2007. On the whole, the assessment of the code in terms of effectiveness is good, in line with the European median. The Portuguese results match the overall EU trends being considered and are above the European median in some cases, e.g. balance between hard law and soft law, diversity of companies taken into account by the code, etc. The overall assessment of the code is positive, in particular regarding its impact on management, shareholders, and stakeholders. The overall structure of the CMVM code is considered adequate, but the respondent takes a neutral stance on whether its recommendations are clearly formulated. The comply-or-explain principle offers more flexibility for companies to implement adequate corporate governance structures than regulation, but this flexibility is still not sufficient.

Slovenia

The Slovenian Corporate Governance Code was issued in 2004 and revised in 2005 and 2007 (to be revised again in 2009) by the Ljubljana Stock Exchange, the Association of Supervisory Board Members, and the Managers' Association of Slovenia. The responses from the business' representatives are not based on the corporate governance code but on the Companies Act issued in 2006 and revised twice in 2007 and in 2008. The assessment of the Slovenian code is not homogeneous and gives rise to, occasional extreme ratings. For instance, the very positive effect of the Slovenian code on "awareness of the interests of stakeholders" and on "awareness of the interests of potential shareholders/ financial markets" is assessed higher than the European median. The overall effects of the Slovenian code on governance activities are better rated for the two-tier system than for the one-tier. Unlike the European median score, "internal governance" and "board transparency" are well-treated in the Slovenian code. On the contrary, the influence of controlling shareholders over the effectiveness of the comply-or-explain system is assessed as very negative, and Slovenia is the country rated as most below the European median.

Spain

The Spanish Unified Good Governance Code of Listed Companies (Conthe Code) was approved in May 2006 and has been in operation since January 1st, 2007. It was issued by the Comisión Nacional del Mercado de Valores (CNMV), the Spanish Securities Market Commission. On the whole, the assessment of the code in terms of effectiveness is slightly above the European median score. Although the code is considered to be well-advanced, its implementation is not considered as complete. The directors' perception regarding the effects on shareholders is very positive and two points higher when compared with the European median score for directors only. The three respondents have common views except when the details of the code are considered. Although there is a consensus that the Conthe Code generally deals with the appropriate topics, it appears that quite a number of topics need refinement. The comply-or-explain principle does not take sufficiently into account the specific situation of a company, unlike in most European countries. Spain is one of the very few countries from the EU-15 clearly calling for the alignment of corporate governance codes at the EU level.

Sweden

The Swedish Code on Corporate Governance has been in force since 2005 and was revised in 2008. It was drafted by the Swedish Corporate Governance Board. On the whole, the assessment of the code in terms of effectiveness of the initial objectives reached is positive, matching the European median score. Director assessments are generally slightly above the assessment made by business. This observation may be due to the fact that many principles in the Swedish corporate governance code already existed before the code was implemented through company law rules or by practice of individual companies which are not taken into account when assessing the code. Respondents highlight their belief that the code functions properly and companies are committed to its application. Respondents report that the overall structure of the Swedish corporate governance code is considered highly adequate, and its recommendations are clearly formulated.

United Kingdom

The UK Combined Code on Corporate Governance (and associate guidance: the Turnbull Guidance, the FRC Guidance on Audit Committees and the Higgs Report), was first published by the UK Financial Reporting Council in 1998 in the wake of previous initiatives like the Cadbury Report of 1992 and the Greenbury Report of 1995. The perception of the Combined Code - and the associated comply-or-explain principle -, is very positive and above the European median score in terms of effectiveness, content, structure, balance with hard law, and diversity taken into account amongst listed companies. As a result, improved governance standards have been achieved without incurring significant compliance costs or by stifling the wealth creation process. This consensus assessment across respondents is often higher than the European median score, if not the highest one in the EU. However, the Combined Code did not manage to have real impacts on the "awareness of the interests of stakeholders", which is assessed as neutral, in line with the European median score.

4 SUMMARY OF FINDINGS

- The findings conclude that the corporate perception of national corporate governance codes in the EU is positive but varies depending on the category of respondent, country, and on how long the national corporate governance code has been in place.

- Although the majority of national corporate governance codes do not deal with all the issues covered in the questionnaire, the overall structure of corporate governance codes and the clarity of their recommendations are assessed as satisfactory by company representatives. Respondents find the corporate governance codes are effective in reaching their initial objectives. However, in some countries it is not clear if the positive assessment is due to the quality of the code itself, to legislation implemented before the code came into force, or to companies' internal practices before the implementation of the code.

- Respondents consider national corporate governance codes as less effective in reaching objectives linked to wealth creation ("better competitive position in market", "long-term value creation", "lower cost of external funding" and "foreign investment") than in reaching other objectives.

- The overall assessment of the effectiveness of the national corporate governance codes in reaching their initial objectives is largely positive in most of the countries.

- Respondents consider that national corporate governance codes have positive effects on the corporate governance mechanisms of boards ("functioning of the board", "independent directors", "introduction of board committees", etc.) but that they have almost no effect on issues linked to company strategy, risk management from the perspective of strategic scenarios and product development, and remuneration. In addition, it is important to note that corporate governance codes are not considered as playing a significant role in increasing director competence.

- Similarly, respondents consider issues relating to the corporate governance mechanisms of boards as more detailed and complete in the national corporate governance codes than those relating to "risk management from the perspective of strategic scenarios and product development" or "transparency on financial and non-financial risk profile". However, as one respondent points out, the lower scores should not necessarily be interpreted as a negative outcome as far as strategic decisions are concerned since the ability of a corporate governance code to contribute in this field is limited.

- Respondents find national corporate governance codes have a positive effect on topics related to shareholders and stakeholders.

- There is a consensus that the effect of the national corporate governance codes on management is positive.

- Respondents assess the effect of national corporate governance codes on the one-tier and two-tier board systems similarly, even in countries where both board systems exist (Bulgaria, France, Hungary, Italy, and Slovenia), although there are slight differences in assessment in certain countries.

- Although the balance between hard law and soft law is considered satisfactory, the existing overlaps and conflicts between soft law and hard law remain important.

- In some countries, corporate governance is seen as over-regulated. Some respondents point out that self-regulation represents a more effective corporate governance tool than hard law since it is able to take diversity at listed companies into account.

- Respondents have different opinions on what topics should be addressed under hard law or soft law (e.g. corporate social responsibility, internal governance, etc.). Hard law may, however, be considered appropriate when self-regulation remains without effect and for certain topics e.g. in respect of shareholder rights. Therefore, the balance between hard law and soft law remains an area of ongoing debate.

- The majority of respondents believe that national corporate governance codes have not prevented adoption of legislation at national level. The codes have also not tended to prompt the adoption of new legislative proposals.

- Respondents do not widely support introduction of a European corporate governance code. However, benchmarking and learning lessons from the other codes is perceived as sound practice.

- Respondents find the comply-or-explain principle offers sufficient flexibility for companies to implement the right corporate governance structures, due to the fact that it is able to accommodate the specific situation of a company.

- Most respondents find that shareholders are willing to accept the explanations from companies when they depart from the principles of the code. However, company explanations for such deviations are often very general (i.e. boilerplate).

- There is a broad view amongst respondents that the benefits of implementing the national corporate governance code recommendations and of transparency in this regard exceed compliance costs. However, these costs are viewed as remaining too high for SMEs.

- There is some divergence between director perceptions and those of business associations for countries where the codes are recent and where more time is needed to assess their influence.

- The directors' median response (across all countries in the survey) is in line with the overall assessment, except when the completeness of the codes regarding "internal governance" is concerned. This subject is well-treated according to the overall survey median, whereas it is not sufficiently treated according to directors only.

- Currently, some Member States are revising their codes in the context of the financial crisis and, as some respondents have noted, such an exercise should be undertaken regularly, when justified by and in order to incorporate market developments.

CHAPTER IV – INVESTOR PERCEPTION OF CORPORATE GOVERNANCE CODES

1 INTRODUCTION

This chapter measures the perception of 100 mainly EU-based investors on national corporate governance codes in the 27 Member States. It also analyses investor perception on the current monitoring and enforcement practices in the EU. Specifically, it addresses the following issues:

- investor assessment of company corporate governance disclosure;
- investor corporate governance practices;
- investor perception of their entitlement to exercise their rights.

This chapter is based on the responses to a web-based survey[252] to institutional investors with European holdings. The response rate to the survey (100 respondents from over 2,000 investors contacted, representing over EUR 400 billion of assets under management in the EU) leads to cautious conclusions, as the group of respondents may be seen as a self-selecting group of – above average - engaged institutional investors.

Methodology:

This chapter was drafted by RiskMetrics, based on a survey developed by RiskMetrics, approved by the European Commission, and emailed to over 2,000 institutional investors, primarily based in Europe, whose portfolios include a significant proportion of shares issued by EU listed companies[253]. In addition, RiskMetrics asked for responses from associations of institutional investors as well as associations of retail shareholders.

The following three tables provide an overview of the 100 respondents, by investor type and by country of origin.

Figure IV-1-1: **Overview of respondents per investor type**

Investor type	Nr of institutional investors
Asset Manager / Mutual Fund	66
Pension Fund	10
Insurance Company	3
Hedge Fund	0
Endowment, Charity, Foundation	0
Investor Trade Association	9
Government / Sovereign Wealth Fund	4
Stewardship Services	2
Other	6
Total	100

[252] See Appendix 3 for a transcribed version of the survey.
[253] See Annex 1 for a more detailed methodology.

Figure IV-1-2: **Overview of respondents per country of origin and Member State of investment**

Country of origin	Nr of institutional investors
Austria	1
Belgium	3
Bulgaria	1
Denmark	1
Finland	2
France	8
Germany	6
Greece	1
Ireland	1
Italy	3
Japan	1
Jersey	1
Luxembourg	1
Netherlands	12
Norway	3
Portugal	1
Spain	1
United Kingdom	45
United States	8
Total	100

Country of investment (in the EU)	Nr of institutional investors
Austria	4
Belgium	5
Bulgaria	2
Cyprus	1
Czech Republic	2
Denmark	6
Estonia	0
Finland	3
France	40
Germany	48
Greece	5
Hungary	1
Ireland	3
Italy	8
Latvia	1
Lithuania	0
Luxembourg	4
Malta	0
Netherlands	16
Poland	1
Portugal	3
Romania	1
Slovakia	0
Slovenia	0
Spain	9
Sweden	6
United Kingdom	43

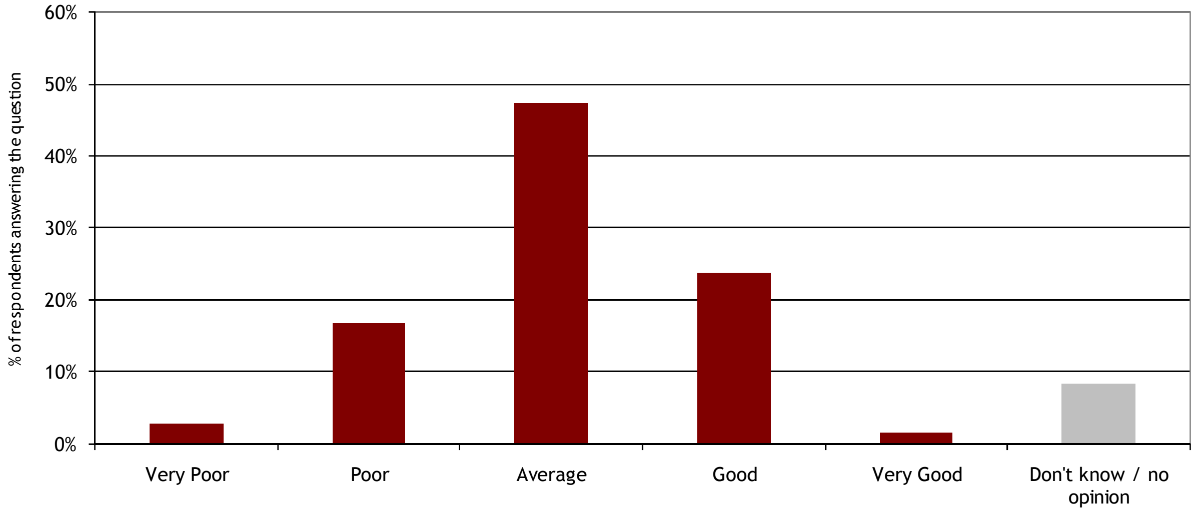
2 INVESTOR ASSESSMENT OF COMPANY CORPORATE GOVERNANCE DISCLOSURE

This section seeks to examine how investors perceive company corporate governance disclosure and explanations, whether there have been improvements in recent years, and whether there are particular areas where additional focus is required.

The respondents were asked to indicate their perception of company disclosure regarding explanations for deviations from corporate governance provisions. The quality of disclosure was evaluated on a scale from "very poor" to "very good".

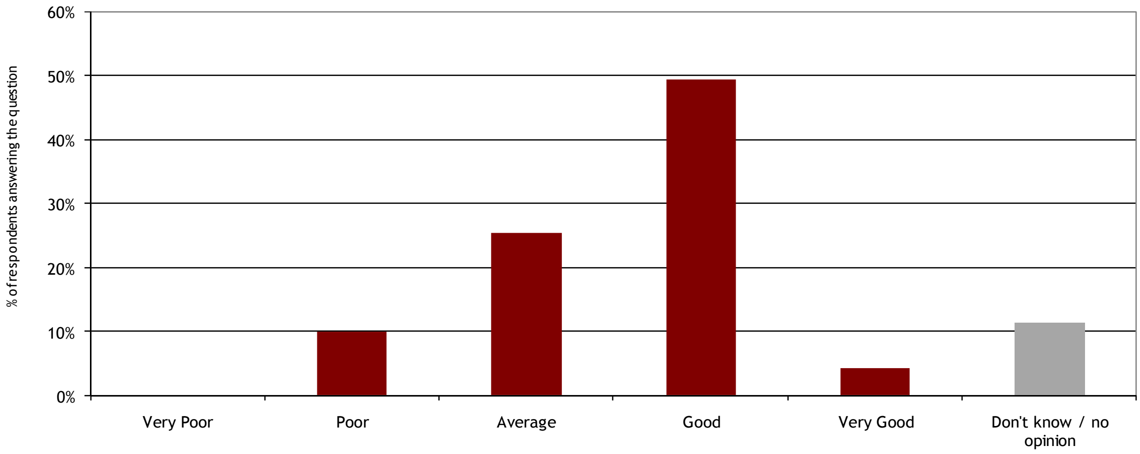
The results show that investors are not entirely satisfied with the quality of corporate governance disclosure: 20 percent of investors think that the quality is "poor" or "very poor", while 47 percent think it is average. Only a quarter of investors consider the quality "good" or "very good".

Figure IV-2-1: **Perception of the quality of company disclosure**[254]



Nevertheless, investors note positive improvements in the quality of corporate governance disclosure over the last three years. 54 percent of respondents have indicated that the quality of disclosure has improved. The following graph provides further details.

Figure IV-2-2: **Perception of improvement of company disclosure in the last 3 years**[255]



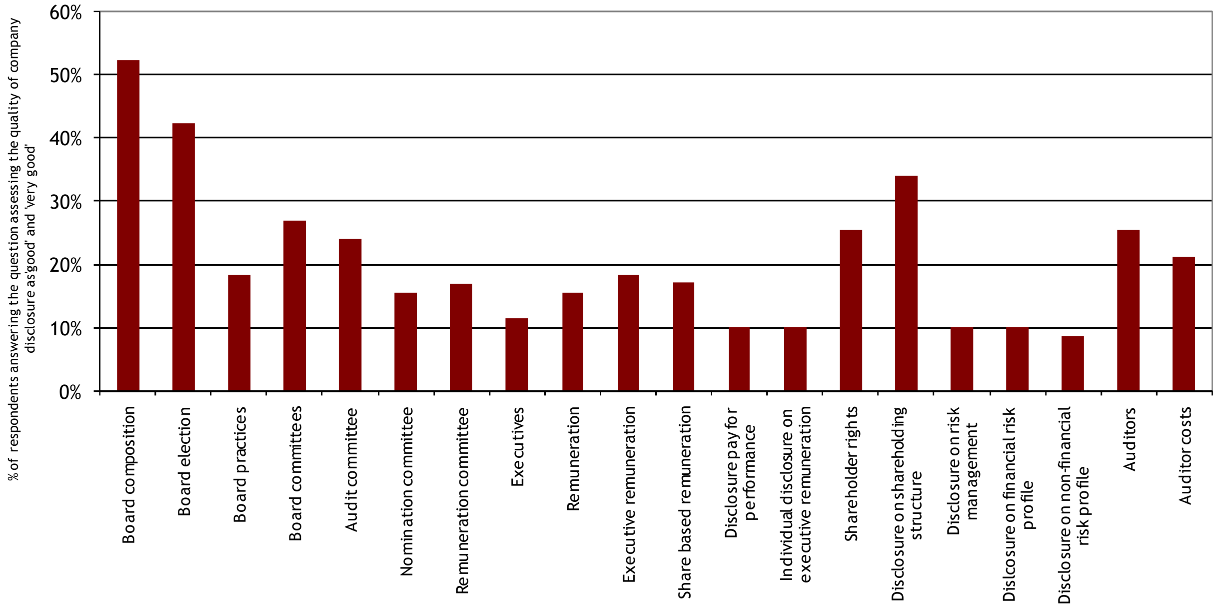
[254] Results based on 72 respondents answering the questions. 28 respondents did not answer this question.
[255] Results based on 71 respondents answering the questions. 29 respondents did not answer this question.

Furthermore, the respondents were asked to assess the quality of disclosure on specific issues. The figure below presents the aggregation of "good" and "very good" explanations per issue.

Figure IV-2-3 shows that risk and remuneration are the two main areas for which explanations are perceived as having the poorest quality. According to investor views, the disclosure is worst regarding risk management, financial risk exposure, and non-financial risk profile. The focus on these risk issues is, however, relatively new to corporate governance. Regarding executive remuneration, disclosure is considered poorer on pay for performance and on individual disclosure on executive remuneration. Disclosure on individual remuneration is still quite poor, despite the existence of a suggestion on the matter since 2004 in the Commission Recommendation[256].

On the other hand, investors think that the disclosure on board composition (52 percent), board election (42 percent), and shareholding structure (34 percent) is of relatively good quality.

Figure IV-2-3: **Perception of current quality of company disclosure of corporate governance explanations for specific issues**[257]

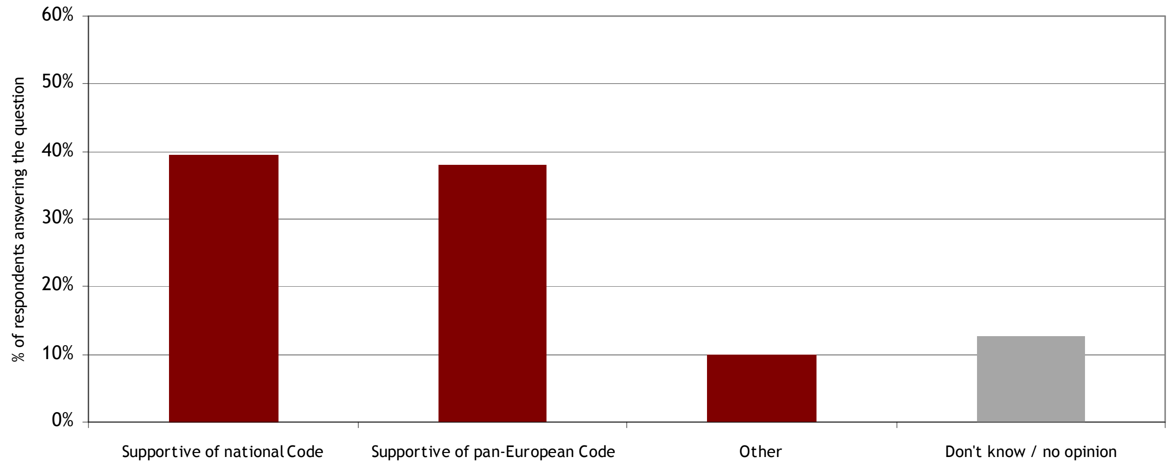


Additionally, three questions were posed in order to examine investor perception of the corporate governance framework as a whole. First, investors were asked to express their views on the functioning of comply-or-explain as an enforcement mechanism. Second, investor opinion was gauged concerning certain legislative developments meant to make the comply-or-explain mandate more operative. The third question focused on the co-functioning of regulatory and comply-or-explain systems in providing sufficient coverage of all important corporate governance issues.

Figure IV-2-4 shows that 77 percent of respondent investors are supportive of a comply-or-explain mandate, with 39 percent supporting European national codes, and 38 percent supportive of a pan-European code.

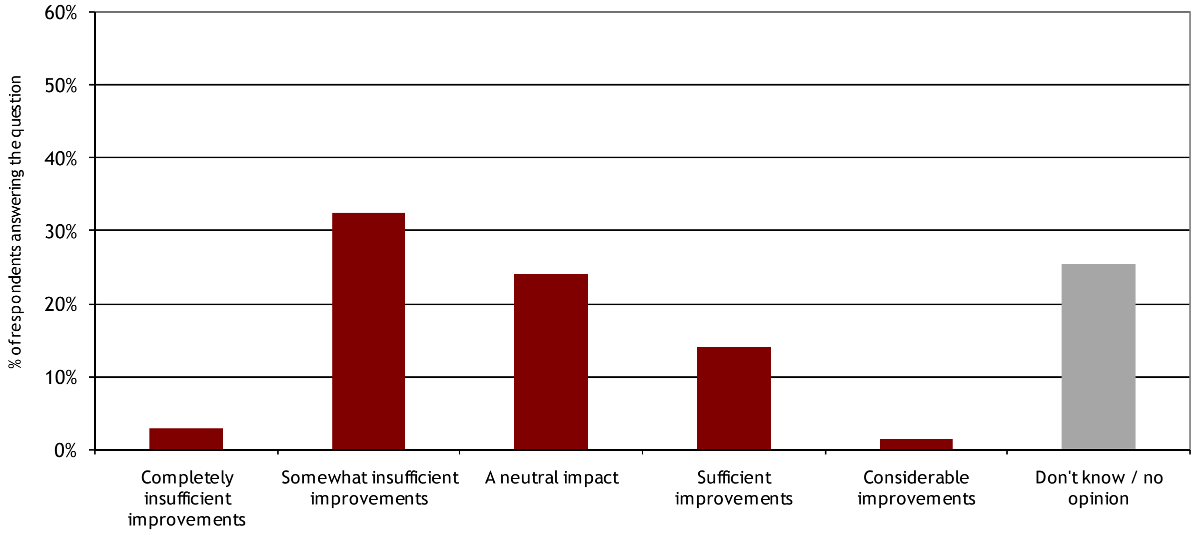
256 See footnote 81.
257 Results based on 71 respondents answering the questions. 29 respondents did not answer this question.

Figure IV-2-4: **Support for a comply-or-explain approach**[258]



In the respondents' opinion, neither the reporting duty of audit committees (Article 40 of Directive 2006/43/EC[259]) nor the reporting duty of the board on a comply-or-explain basis (Article 1 of Directive 2006/46/EC[260]) represents a sufficient improvement for making the corporate governance framework more operative. Instead, respondents believe that these factors have only a neutral effect.

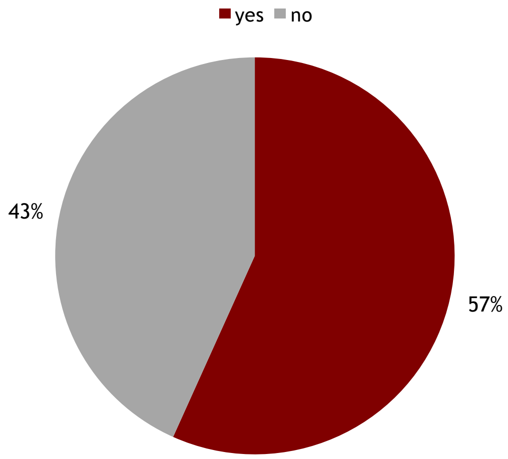
Figure IV-2-5: **Assessment of the EU legislative framework evolution**[261]



Investors were also asked to give their opinion on whether the corporate governance framework covers all important issues relating to corporate governance.

[258] Results based on 71 respondents answering the questions. 29 respondents did not answer this question.
[259] See footnote 77.
[260] See footnote 18.
[261] Results based on 71 respondents answering the questions. 29 respondents did not answer this question.

Figure IV-2-6: **Does the corporate governance framework cover all important issues relating to corporate governance?**[262]



As figure IV-2-6 shows, the majority of respondents think that the combination of legislation and comply-or-explain-based corporate governance codes provides sufficient coverage on all important corporate governance matters.

[262] Results based on 67 respondents answering the questions. 33 respondents did not answer this question.

3 INVESTOR CORPORATE GOVERNANCE PRACTICES

This section seeks to determine the extent to which institutional investors exercise their rights to assess company corporate governance statements and the extent to which this information is integrated into their investment management decision making. The findings in this section will also provide insight on the practical level of engagement and voting by institutional investors.

NOTE: As mentioned previously, of over two thousand investor organisations invited to respond to this survey, only one hundred decided to do so. It is impossible to rule out that these respondents form a self-selecting group of investors actively engaged in corporate governance. Therefore, the results of this section cannot necessarily represent the practices of institutional investors as a whole.

Of the sample of 100 respondents, the vast majority have a corporate governance or voting policy (94 percent), and just less than three quarters (73 percent) disclose this information publicly.

Figure IV-3-1: **Does your organisation have a corporate governance or voting policy?**[263]

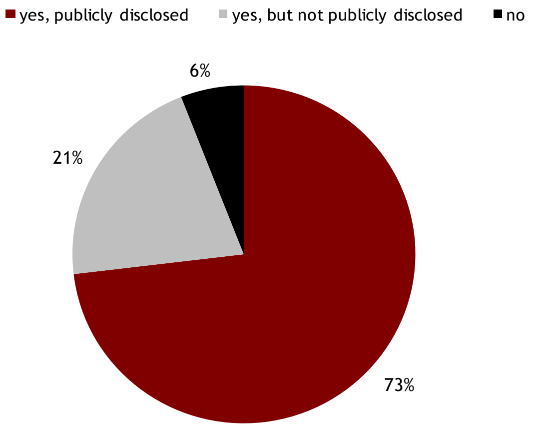
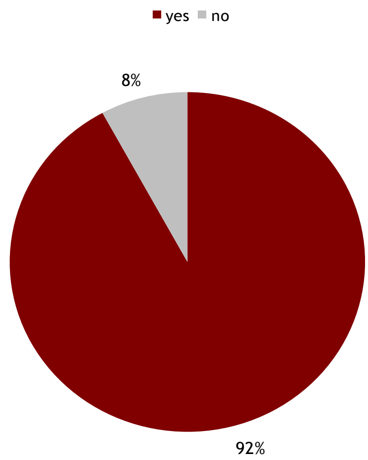


Figure IV-3-2: **Did you exercise the voting rights attached to equities in your portfolio in the course of 2008?**[264]



The vast majority (92 percent) of respondents exercised their voting rights in the course of 2008, at least to some extent.

[263] Results based on 67 respondents answering the questions. 33 respondents did not answer this question.
[264] Results based on 63 respondents answering the questions. 37 respondents did not answer this question.

Figures *IV-3-3* and *IV-3-4* show the level of voting activity in 2008 as percentages of companies held and as percentages of assets under management, respectively:

- 56 percent of investors vote at least 75 percent of their equities as a percentage of companies held, whereas 44 percent vote less than 75 percent, and
- 53 percent of investors vote at least 75 percent of their equities as a percentage of assets under management, whereas 47 percent vote less than 75 percent.

Figure IV-3-3: **Indicate percentage of equities voted as a percentage of companies held in 2008**[265]

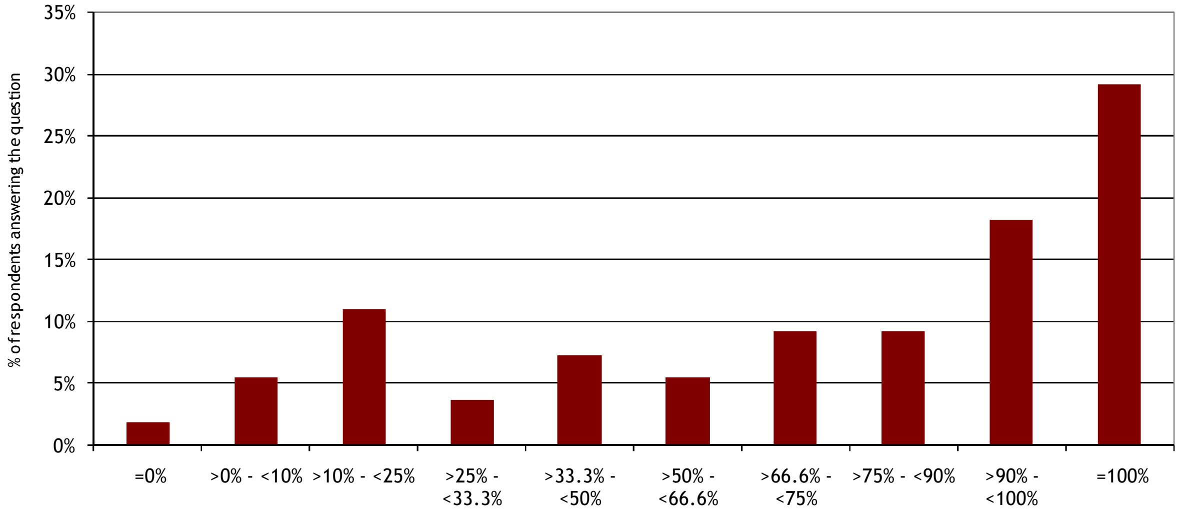
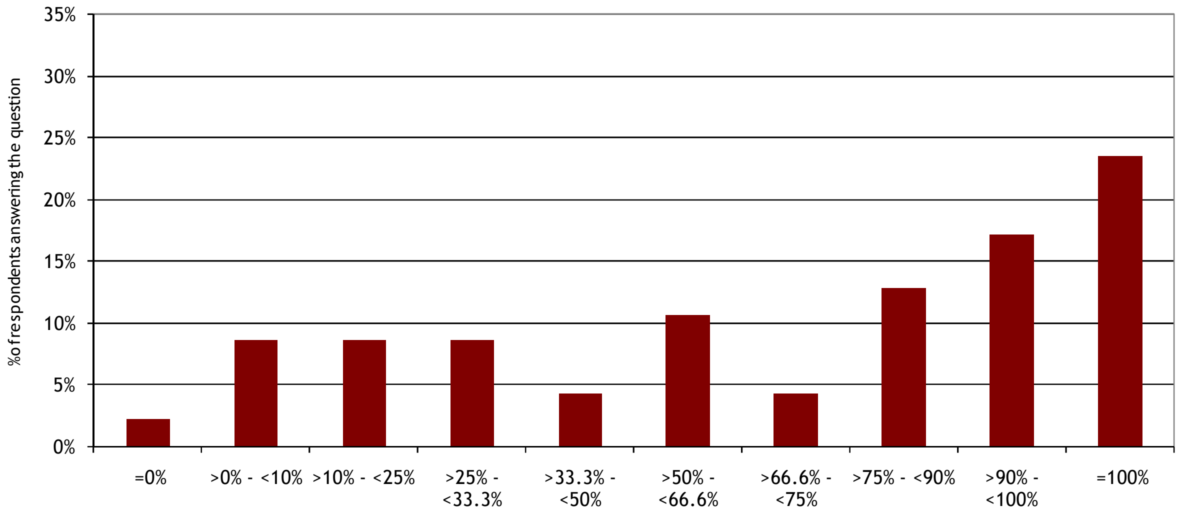
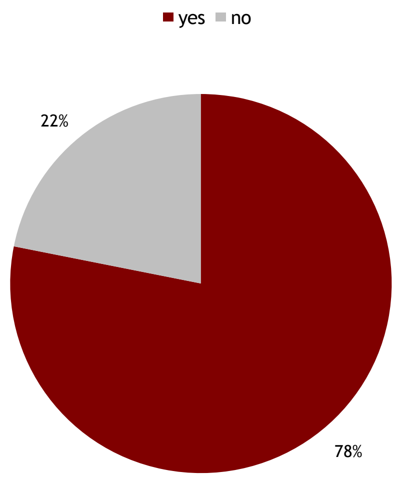


Figure IV-3-4: **Indicate percentage of equities voted as a percentage of assets under management held in 2008**[266]



[265] Results based on 55 respondents answering the questions. 45 respondents did not answer this question.
[266] Results based on 47 respondents answering the questions. 53 respondents did not answer this question.

Figure IV-3-5: **Have you used a vote against management in the course of 2008 as a result of inadequate explanations?[267]**



Investors were asked about the use of votes cast against management in case of inadequate explanations.

The results show that over three quarters (78 percent) have used at least one vote against management in the course of 2008 as a result of inadequate explanations. Just over half (53 percent) stated that their organisation would be prompted to do so "sometimes," and over a quarter (28 percent) mentioned they would do so "often" or "very often." These findings suggest rather active participation among respondents.

Finally, investors were given a group of questions on their engagement activities, namely the scale of their engagement activities, their form, and how they report them.

Three quarters (76 percent) of respondents state that the implementation of a corporate governance or voting policy includes engagement. A third of respondents (33 percent) engage with 10 to 50 percent of the companies in their portfolio, while two-thirds (67 percent) engage with less than 10 percent of the companies in their portfolio.

Figure IV-3-6: **Does the implementation of your corporate governance or voting policy include engagement?[268]**

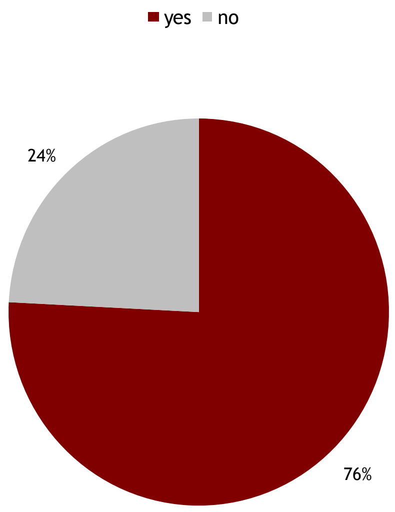
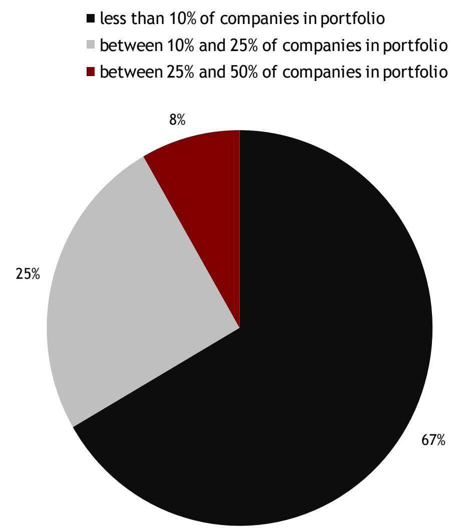


Figure IV-3-7: **What is the scale of your engagement?[269]**



[267] Results based on 64 respondents answering the questions. 36 respondents did not answer this question.
[268] Results based on 62 respondents answering the questions. 38 respondents did not answer this question.
[269] Results based on 48 respondents answering the questions. 52 respondents did not answer this question.

82 percent of respondents report on engagement and voting activity. Voting activity disclosure can take the form of disclosing full voting records (30 percent), summary reports (26 percent), details on each vote cast against management (25 percent), or other formats (19 percent).

Figure IV-3-8: **Reporting on voting and/or engagement activity**[270]

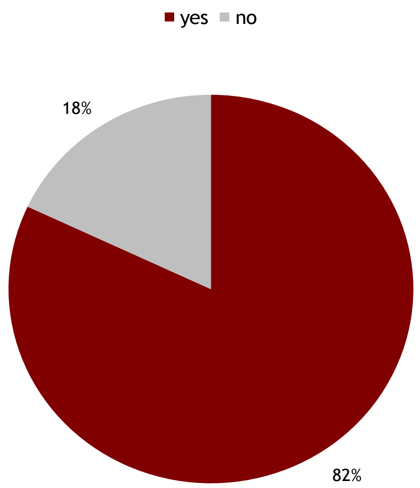
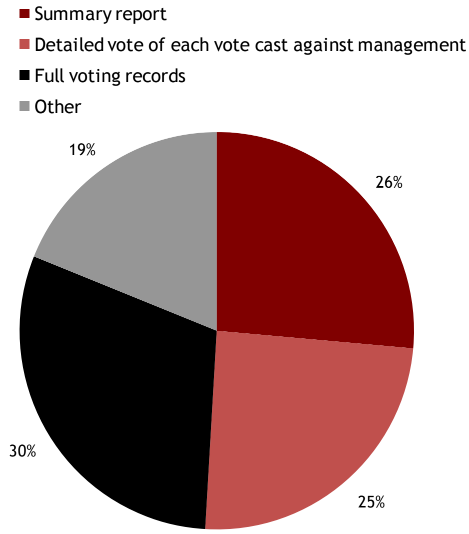
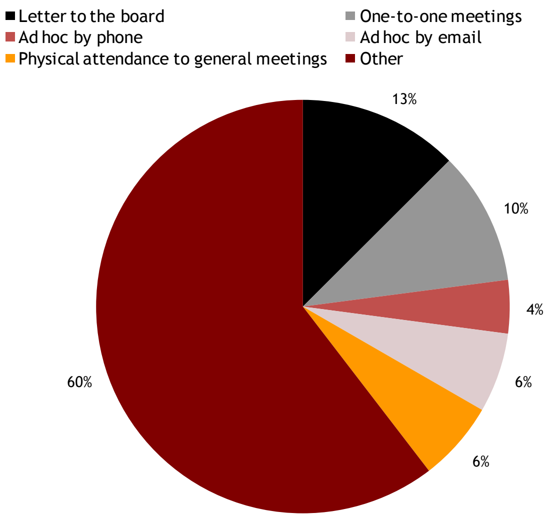


Figure IV-3-9: **Form of reporting on voting activities**[271]



According to the respondents, engagement most usually takes the form of a combination of activities rather than consisting of one single activity.

Figure IV-3-10: **Form of the engagement**[272]



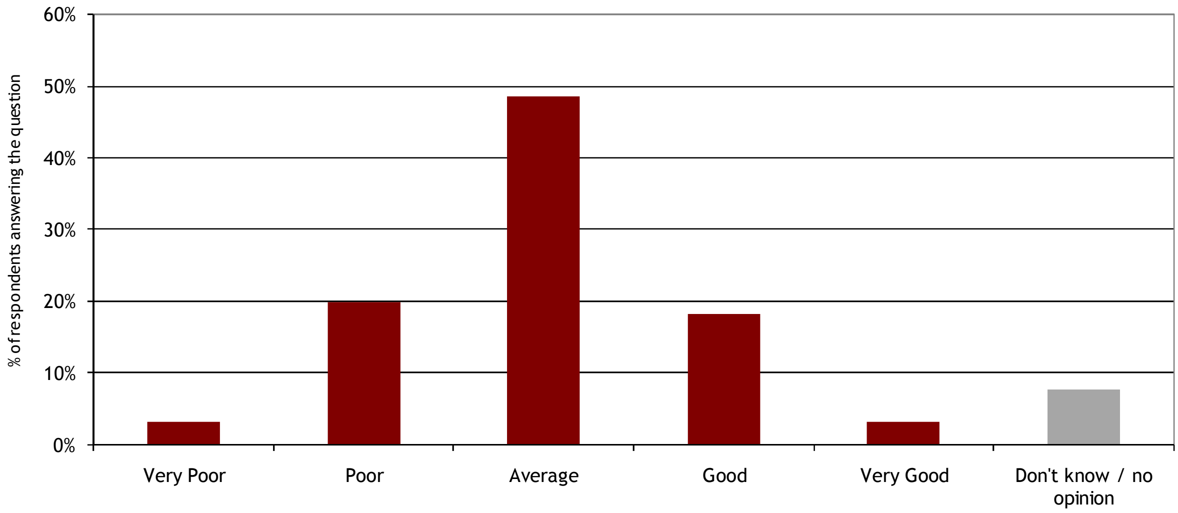
[270] Results based on 61 respondents answering the questions. 39 respondents did not answer this question.
[271] Results based on 53 respondents answering the questions. 47 respondents did not answer this question.
[272] Results based on 48 respondents answering the questions. 52 respondents did not answer this question.

4 INVESTOR PERCEPTION ON THEIR ENTITLEMENT TO EXERCISE THEIR RIGHTS

This section aims to examine investor views on their entitlement to exercise their rights to assess company corporate governance statements. It also addresses the question of whether certain shareholder rights should be enhanced. Finally, this part probes investor opinion about the influence of important shareholders for the functioning of the corporate governance framework.

Almost half of respondents think that their entitlement to exercise their right to assess company corporate governance statements effectively is "average".

***Figure IV-4-1:* Perception of whether shareholders in Europe have an adequate entitlement to exercise their right to assess corporate governance statements effectively**[273]



The majority of respondents feel that shareholder rights need enhancement in two areas: the vote on remuneration statements and the vote on corporate governance statements.

Figure IV-4-2: **Should shareholders' right to vote on a remuneration statement be enhanced?**[274]

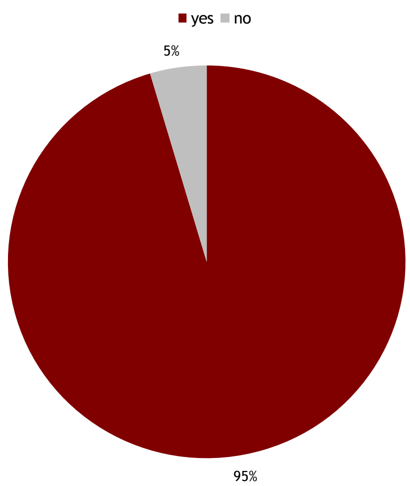
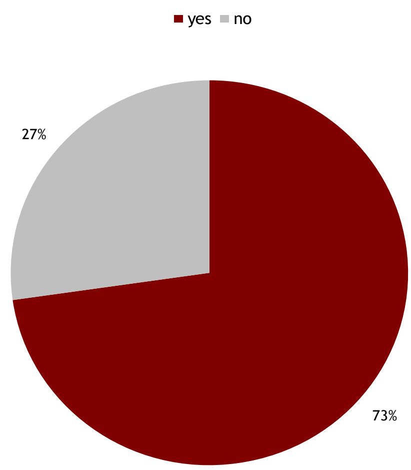
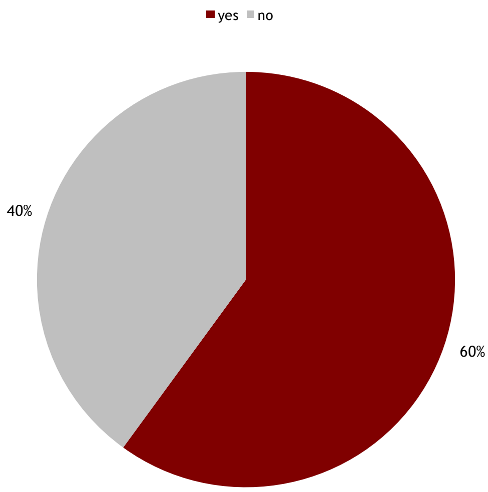


Figure IV-4-3: **Should shareholders' right to vote on a corporate governance statement be enhanced?**[275]



[273] Results based on 66 respondents answering the questions. 34 respondents did not answer this question.
[274] Results based on 65 respondents answering the questions. 35 respondents did not answer this question.
[275] Results based on 65 respondents answering the questions. 35 respondents did not answer this question.

Figure IV-4-4: **In favour of shareholders being required to report on the implementation of their corporate governance policy**[276]

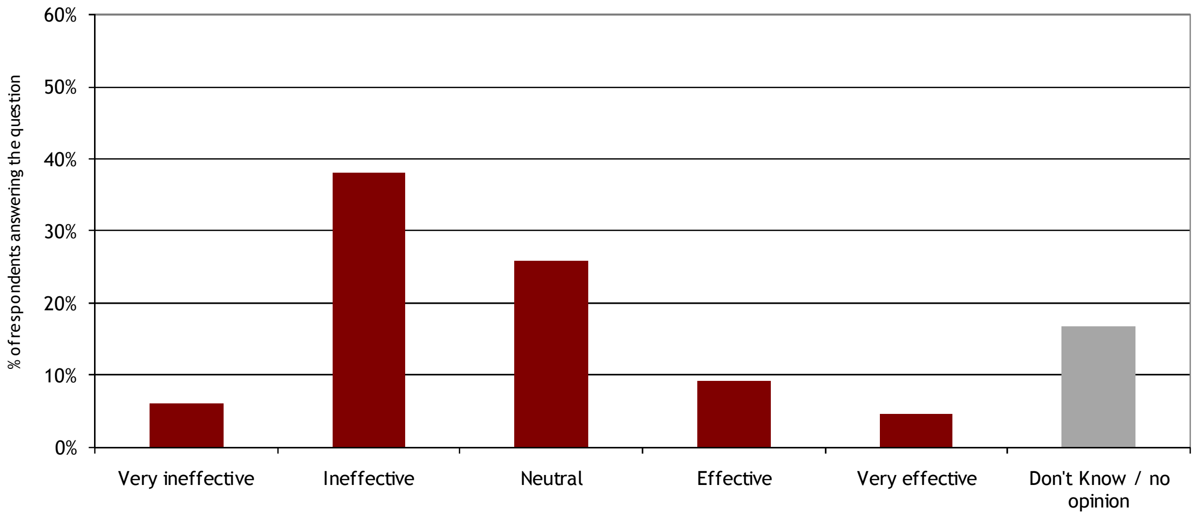


Investors think that enhancement is required not only with respect to shareholder rights but also shareholder responsibilities.

60 percent of respondents share the opinion that there should be a requirement for institutional investors to report on the implementation of their corporate governance policy.

The last two questions concern situations when companies have a controlling shareholder. A significant minority (46 percent) assess the influence exerted by controlling shareholders as "negative" or "very negative" for the successful implementation of corporate governance codes. Further, another significant minority (46 percent) perceive the effectiveness of the comply-or-explain mechanism itself as negatively affected by the presence of controlling shareholders.

Figure IV-4-5: **Perception of the effectiveness of the comply-or-explain regime of corporate governance codes in relation to the presence of controlling shareholders**[277]



[276] Results based on 65 respondents answering the questions. 35 respondents did not answer this question.
[277] Results based on 66 respondents answering the questions. 34 respondents did not answer this question.

5 SUMMARY OF FINDINGS

- Based on 100 responses from a survey of institutional investors, the findings show that the majority of respondents (77 percent) are supportive of a comply-or-explain regime, among which a strong minority of respondents (38 percent) support the creation of a pan-European code. Moreover, more than half of the respondents (57 percent) think that there is an acceptable balance between comply-or-explain-based codes and legislation, which together cover all important issues relating to corporate governance.

- Only a quarter of investors consider the quality of company disclosure on corporate governance issues as “good” or “very good”. Nevertheless, a large number of investors believe that there has been improvement in the disclosure practices over the last three years.

- Quality of disclosure is not uniform: it is perceived as poorest in the areas of risk management and remuneration, and best in the area of board composition, director elections, and shareholding structure.

- The response rate to the survey (100 respondents, from over 2,000 investors contacted) suggests that institutional investor involvement on corporate governance issues is not very widespread. However, within this group of 100 respondents, institutional investors tend to exercise their rights actively. They usually have an investment policy, actively engage with companies and use their voting rights, and often disclose all this information.

- Almost half of the respondents think that shareholder entitlement to exercise their rights to assess corporate governance statements are “average”. There is strong support for the enhancement of shareholder rights, including the right to vote on remuneration statements (95 percent of respondents) and on corporate governance statements (73 percent of respondents).

- The majority of investors (60 percent) think that *all* shareholders should be asked to report on the implementation of their corporate governance policy.

- A significant part of the respondents (46 percent) consider the presence of important shareholders as having a negative impact on the successful implementation of corporate governance codes and undermines the effective functioning of the comply-or-explain approach.

CHAPTER V - CONCLUSIONS AND RECOMMENDATIONS

1 INTRODUCTION

The comply-or-explain principle has become a feature of the EU approach to corporate governance. National corporate governance codes lay down rules or recommendations that are not mandatory, but with which companies must either comply or publicly explain any deviations. Today, market participants from both the issuer as well as the investor community broadly support the comply-or-explain approach.

Nevertheless, it is apparent that certain deficiencies in the practical application of the comply-or-explain mechanism might affect its proper functioning, and thereby prevent it from attaining its goal of improved corporate governance practices.

These deficiencies are not cause to abandon this approach. Rather, they can highlight areas of potential improvement, and may also indicate how the comply-or-explain approach as a whole can be strengthened.

This Chapter will identify the problems related to the implementation of the comply-or-explain approach and examine the measures that can be taken to improve this system. After a concluding summary of the current state of play in the field of comply-or-explain-based corporate governance, it will review the three pillars considered essential for the comply-or-explain approach to be effective[278]:

- a real obligation to comply or explain,
- a high level of transparency, with coherent and focused disclosure, and
- a way for shareholders to hold company boards ultimately accountable.

A number of suggestions to the different actors of the corporate governance arena will be developed along with the conclusions. For each of these, this Chapter will attempt to highlight the advantages and disadvantages as well as identify the types of Member States where they could be most effectively applied. These suggestions are based on information gathered for the purpose of this Study, and also echo recommendations made by other market participants. The suggestions should be seen in the context of this Study, which analyses a snapshot of corporate governance practices within a defined time span. Further action on the suggestions as presented in this Chapter would therefore call for additional analysis in the form of impact assessments by the European Commission or individual Member States.

[278] Following a framework developed by the European Corporate Governance Forum in its Statement on the Comply-or-explain Principle, dated February 22nd, 2006; available at: http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf-comply-explain_en.pdf.

2 BROAD ACCEPTANCE OF THE COMPLY-OR-EXPLAIN MECHANISM BY MARKET PARTICIPANTS

The careful scrutiny of the various market participants' opinions shows an overwhelming support for the comply-or-explain regime from regulators, companies or investors:

- ***Regulator perspective:*** The comply-or-explain approach enjoys the support of regulators both on EU and national level. The European Commission expressed its preference for this approach by adopting the Directive 2006/46/EC[279], which mandated[280] the application of corporate governance codes by way of comply-or-explain. Moreover, even before the harmonisation at EU level, the comply-or-explain mechanism had already been endorsed by many Member States. The European Corporate Governance Forum had also expressed strong and unanimous support for the comply-or-explain approach in 2006, as it judged it "best suited to take into account the variety of situations of individual companies" [281], and as it was considered to adapt well to the differences between national laws and governance framework. The ECGF, supported in this by the European Commission, considers that "when it is effectively implemented, this is better and more efficient approach than detailed regulation". Therefore, the comply-or-explain approach is currently considered the preferred regulatory technique by regulators.

- ***Company perspective:*** The results of the company and director perception survey presented in Chapter III of this Study demonstrate that the great majority of respondents consider soft regulation in the form of corporate governance codes applied on a comply-or-explain basis an effective regulatory tool. It is considered to offer sufficient flexibility to accommodate the specific situations of companies. There is a clear indication that soft regulation on a comply-or-explain basis is preferred to hard law, the reason for this being the ability of the comply-or-explain mechanism to take the diversity of needs of listed companies into account. Additionally, the majority of respondents believe that the benefits of implementing corporate governance codes exceed the implementation costs.

- ***Investor perspective:*** The results of the survey of one hundred large institutional investors and institutional investor organisations presented in Chapter IV of this Study conclude that the majority of respondents support the comply-or-explain regime. Moreover, more than half of the respondents think that there is an acceptable balance between legislation and comply-or-explain-based codes. According to them, the combination of law and codes covers all important issues relating to corporate governance. While being generally positive to the comply-or-explain system, investors point to the low disclosure quality of company statements. They also support the enhancement of both shareholder rights and shareholder responsibilities.

  Many institutional investor organisations have expressed their support for the comply-or-explain approach. As an example, the International Corporate Governance Network (ICGN) has stated that they "recognize that the crisis was exacerbated by the failure of governance both within bank boards and, in some cases, by the lack of engagement of shareholders responsible for the oversight. However, [they] believe the right approach now is not to ignore the contribution of governance but to strengthen it"[282].

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[279] Directive 2006/46/EC of the European Parliament and of the Council dated June 14th, 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings; available at: http://eur-lex.europa.eu/LexUriServ/site/en/oj/2006/l_224/l_22420060816en00010007.pdf.

[280] Directive 2006/46/EC alternatively foresees the possibility for Member States to allow companies to report on self-defined corporate governance principles which however need to be made public.

[281] Statement of the European Corporate Governance Forum on the Comply-or-explain Principle, dated February 22nd, 2006; available at: http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf-comply-explain_en.pdf.

[282] ICGN, G20 Leaders Summit: the role of corporate governance in restoring stability, dated March 23rd, 2009; available at: http://www.icgn.org/files/icgn_main/pdfs/news/icgn_letter_to_the_ukpm_24_ march_09.pdf, last visited on June 10th, 2009.

3 NEED TO IMPROVE THE PRACTICAL APPLICATION OF COMPLY-OR-EXPLAIN

Although the comply-or-explain approach is considered an appropriate and efficient regulatory tool by a large majority of market actors and regulators, there is also a wide consensus that the mechanism does not function perfectly. Moreover, the role of deficiencies in corporate governance practices was highlighted as one of the causes of the late 2000 financial crisis[283].

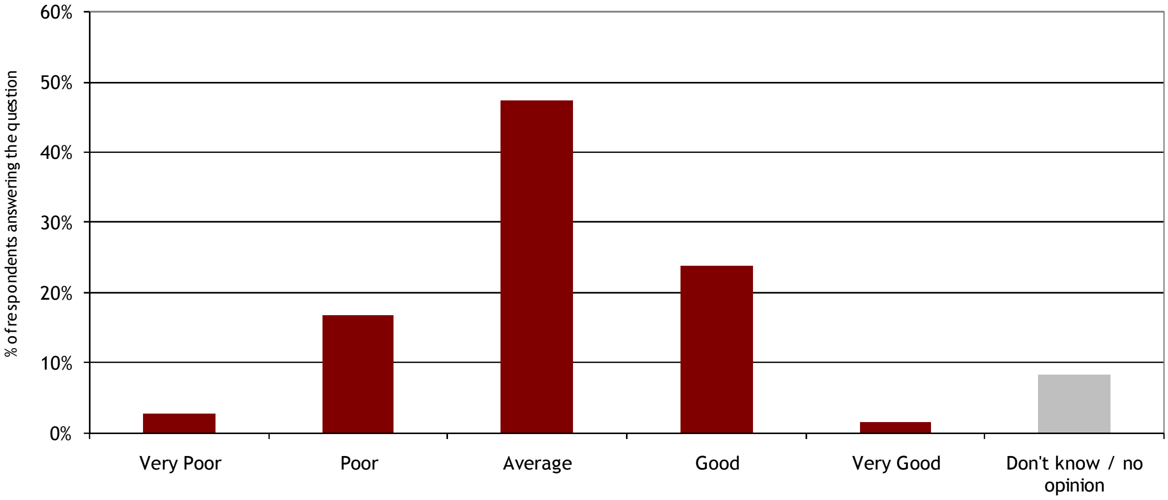
Companies bear the onus for the lack of implementation of good corporate governance practices, for example in the fields of risk management and remuneration, and for inadequate reporting of their practices.

The onus also falls on investors' shoulders for not exercising their monitoring and enforcement responsibilities diligently. As UK Treasury Minister Lord Myners put it, investors themselves often acted as "absentee landlords"[284]. Although investors have extensive rights to directly or indirectly influence the governance of listed companies, they have been "too reliant and unchallenging" with regard to corporations[285]. Investors are blamed for not having dedicated enough time and resources to ensure effective monitoring. Certain types of investors were also blamed for not properly managing their conflicts of interest and actively encouraging short-termism in companies.

3.1 Level of compliance and analysis of deviations provided by companies

The survey to investors performed by RMG shows that investors are somewhat unsatisfied with the quality of company disclosure. Indeed, only a quarter of respondents consider the quality of company disclosure to be sufficiently good.

Perception of the quality of company disclosure in the EU (assessment by 72 investors)



Simultaneously, and in order to put investors' judgement in context with a more impartial analysis, in Chapter II of this Study RMG conducted an assessment of the level of compliance and an analysis of the availability and quality of explanations for deviations by companies for a sample of 270 companies in 18 Member States[286].

This analysis demonstrated that almost all companies refer to a reference corporate governance document, which in most cases is the national corporate governance code of the country where the

[283] ICGN, Second Statement on the Global Financial Crisis, dated March 23rd, 2009; available at: http://www.icgn.org/files/icgn_main/pdfs/news/icgn_statement_on_the_financial_crisis_23_march_09.pdf.
[284] Speech by Lord Myners delivered on April 21st, 2009 at the conference at Association of Investment Companies; available at: http://www.hm-treasury.gov.uk/speech_fsst_210409.htm.
[285] The Crisis: the role of investors, speech by Hector Sants, Chief Executive, FSA NAPF Investment Conference 2009, March 11th, 2009, available at: http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2009/0311_hs.shtml.
[286] 74 companies were classified as large-cap companies and 196 companies were classified as mid-cap companies.

companies are domiciled. Only a handful of companies did not refer to any corporate governance reference document.

Overall 86 percent of all companies disclose some form of comply-or-explain information[287]. Of the companies disclosing such information, 23 percent disclose compliance with all or most provisions.

Some companies (39 percent of companies disclosing comply-or-explain information) disclose information on a provision-per-provision basis. These companies are especially found in Estonia, Hungary, Portugal, Spain, and to a lesser extent in Poland.

In total 1,141 explanations for deviations of the reference corporate governance code were identified in the total sample of companies analysed. These companies disclose an average of three explanations if one disregards Hungary (the average number of explanations with Hungary included equals 5).

Quality of the explanations for deviations from the reference corporate governance codes in the EU

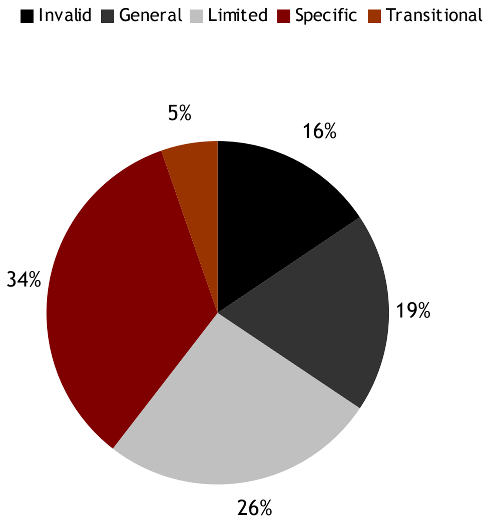
For the purpose of this Study, we have classified the explanations into five categories: Invalid, General, Limited, Specific, and Transitional.

- Explanations of deviations which only indicate a deviation without further explanation were classified as “invalid”.
- Explanations of a general nature in which the company mostly indicates disagreement with the code provision without identifying a company specific situation, were classified as “general”.
- Explanations in which companies do not explain the reasons for deviating from the code, but where additional information was given such as an alternative procedure, were classified as “limited”.
- Explanations relating to a specific company situation were classified as “specific”.
- Finally, if companies indicated that the code provision from which they currently deviate will be applied at a later stage, these explanations were classified as “transitional”.

This typology is used to rank the informative quality for explanations provided by the companies. It does not indicate whether or not the explanations are accurate or acceptable.

[287] The companies not disclosing such information are domiciled in Greece, where no corporate governance code was identified, in Bulgaria (with the exception of two companies) where the code entered into force after the start of this Study. Furthermore three French companies did not disclose such information, as the comply-or-explain approach only entered into force after the start of this Study. Finally, three Luxembourg companies and one Italian company did not disclose comply-or-explain information.

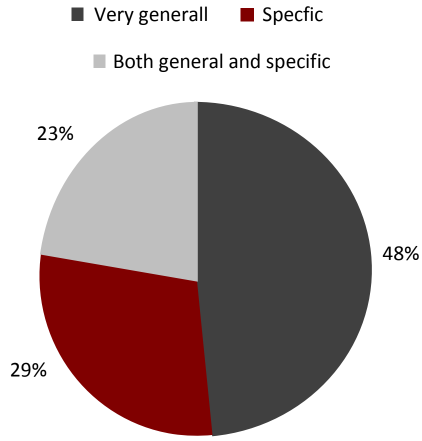
Quality of the explanations for deviations from the reference corporate governance codes in 18 Member States (RMG assessment)



In terms of quality of the explanations, the overall level of "informative" explanations (i.e. "specific" or "transitional") is rather low in the EU. Only 39 percent of all explanations on the reference corporate governance code are classified as sufficiently "informative".

The highest proportion of "informative" explanations is identified in France, the Netherlands, Sweden and the United Kingdom.

Quality of the explanations for deviations from the reference corporate governance codes in 25 Member States (assessment of 42 director institutes and business associations)



Interestingly, the aggregate results of the director institute and business association survey on the matter show similar results. Although the differences of methodology used for the survey and RMG's assessment make parallel observation more complex, the overall assessment of the quality of explanations is somehow comparable. Indeed the proportion of specific explanations is considered to represent around a third of all explanations provided by companies for deviations from the codes. This similarity of results is all the more remarkable when knowing that even business associations – representing companies - come to the same conclusions as RMG's assessment.

However, when broken down at country level, results differ between RMG's assessment and the results of the director institute and business association survey: according to RMG's assessment, the top six Member States in terms of informative quality of company explanation are: Belgium, France, Ireland , the Netherlands, Sweden, and the United Kingdom. According to the director institute and business association survey, the top six Member States in terms of informative quality of company explanation are: Austria, Ireland, the Netherlands, Portugal, Sweden, and the United Kingdom. The quality of disclosure in certain Member States seems therefore to be recognised by director and business representatives, as well as confirmed by RMG's assessment – notably in Ireland, the Netherlands, Sweden and the United Kingdom. For other Member States, the discrepancies of results may be explained by timing issues – for France[288] - or methodology issues – for Austria[289]. The discrepancies of results concerning Belgium are not significant: Belgium was considered a medium performer by director and business representatives whereas the informative quality of the explanations stemming from Belgian companies was considered fairly good in RMG's assessment (60 percent of specific or transitional explanations). The discrepancies of results concerning Portugal

[288] As mentioned previously, the information used for the companies sampled by RMG in France was published during a period where the mandatory comply-or-explain approach had not yet entered into force. Therefore, the results in terms of number of deviations obtained from this analysis cannot be considered representative.
[289] Austria was not analysed in the company practice chapter of the Study.

are much more important: whereas Portugal is considered the worst performer in terms of informative quality of the explanations by RMG, the local business association assesses the quality of the explanations stemming from Portuguese companies as good and specific. As no director institute participated to the survey in Portugal, and only the business association responded to the survey, the discrepancy may come from an overoptimistic assessment of the Portuguese business association.

When reviewing the detailed results of the informative quality of explanations for deviations provided by the sample of 270 companies analysed by RMG, the "specific" explanations most often provided by companies refer to the presence of an important shareholder (16 percent of the "specific" explanations). This result has been found in nearly every country, especially in Belgium and Spain. Other "specific" explanations were generally based on the specificity of company activities, legal references, specific board composition or position of the chairman, set up of a contract before the corporate governance code entered into force and costs related to executing the code provision.

When examining the influence of important shareholders on the informative quality of explanations, the analysis highlighted that only two markets featured a low presence of important shareholders: the UK (2 out of 15 companies with an identified important shareholder) and the Netherlands (3 out of 15 companies with an identified important shareholder). Both of these markets are characterised by displaying the most "informative" explanations. By contrast, in Sweden, all companies have an identified important shareholder, but the informative quality of the explanations is significantly higher than in the rest of companies analysed.

Companies provide comply-or-explain information on six topics:

- board of directors (with issues related to board composition, election, practices, matters regarding committees in general, nomination committee and executives),
- remuneration (with issues evolving around remuneration in general, remuneration committee, non-executive remuneration, executive remuneration, executive contracts, and share based remuneration),
- shareholder rights and duties,
- disclosure,
- audit (with issues related to audit committee, composition of the audit committee, chairman of the audit committee, practices, responsibility towards the internal audit and external auditor), and
- other issues (with issues related to risk management, internal audit function, corporate secretary, and irregularity declaration procedures for employees).

Most information on comply-or-explain relate to the topic of "board of directors", followed by the topic on "remuneration". These two topics together make up almost two-thirds of all explanations.

"Informative" explanations are provided mainly on topics related to "audit committees" (56 percent of "informative" explanations) and on "shareholder rights" 52 percent of "informative" explanations).

The topic on remuneration contains the least "informative" explanations. Only 27 percent of all explanations related to remuneration are classified as "informative". Differences between countries can be significant, but follow the overall trend of all explanations.

Overview of companies disclosing comply-or-explain information in general compared to companies disclosing on a provision-per-provision basis[290]

Disclosure: companies disclosing comply-or-explain information						
	Companies disclosing comply-or-explain information		General information		Provision-per-provision information	
	number of companies	% of total sample	number of companies	% of companies	number of companies	% of companies
All companies	233	86%	141	61%	92	39%
Large-cap companies	68	92%	42	62%	26	38%
Mid-cap companies	165	84%	99	60%	66	40%

As mentioned above, of all companies disclosing comply-or-explain information, the majority of companies (141 companies out of 233 companies disclosing comply-or-explain information) analysed disclose general information on their level of compliance with their reference corporate governance code.

Full compliance: companies disclosing full compliance						
	Companies disclosing full compliance		General information		Provision-per-provision information	
	number of companies	% of total sample	number of companies	% of companies	number of companies	% of companies
All companies	52	22%	48	92%	4	8%
Large-cap companies	17	25%	16	94%	1	6%
Mid-cap companies	35	21%	32	91%	3	9%

A total of 52 companies disclose full compliance with their reference corporate governance code. Nearly all of these companies are part of the group of companies disclosing general information. Only 4 companies disclose full compliance on a provision-per-provision basis.

Average number of explanations for deviations				
	Companies disclosing comply-or-explain information		General information	Provision-per-provision information
	number of companies	% of total sample		
All companies	233	86%	2	10 (5)*
Large-cap companies	68	92%	2	6 (4)*
Mid-cap companies	165	84%	2	12 (5)*

* excluding Hungary

When making the distinction between companies disclosing comply-or-explain information on a general basis and companies disclosing information on a provision-per-provision basis, the latter group has on average a significantly higher number of explanations. Within this group of companies, the average number of explanations is also higher for mid-cap companies than for large-cap companies.

Apart from companies domiciled in Estonia[291], Hungary, Portugal and Spain – where such disclosure is mandatory or strongly recommended -, another 33 companies in various Member States voluntarily disclose on a provision-per-provision basis. In most of these countries, notably in Italy, Luxembourg the Netherlands, Poland and, the UK, companies disclosing on a provision-per-provision basis, disclose a higher number of deviations as their counterparts disclosing only general information. Therefore, whether they are obliged or recommended to disclose on a provision-per-provision basis, or whether they do this on a voluntary basis, companies disclosing on a provision-per-provision basis list an overall higher number of deviations.

The discrepancies between the two groups (general vs. provision-per-provision disclosure) suggest that in case companies do not disclose deviations on a provision-per-provision basis, they might fail to fully disclose all deviations. This may seriously hinder the possibilities for shareholders and other monitors to detect deficient corporate governance practices and react accordingly.

Informative quality of explanations of comply-or-explain information: average proportion of "specific" and "transitional" explanations				
	Companies disclosing comply-or-explain information		General information	Provision-per-provision information
	number of companies	% of total sample		
All companies	233	86%	53%	36%
Large-cap companies	68	92%	48%	40%
Mid-cap companies	165	84%	54%	35%

[290] Out of a total number of 1,141 explanations provided by companies on their reference corporate governance code, 560 explanations are disclosed by Hungarian companies.
[291] In Estonia, 14 out of 15 companies disclose comply-or-explain information on a provision-per-provision basis.

Overall, the analysis of the quality of the explanations provided by EU companies on areas of deviations from a corporate governance code has shown that less than half of the explanations provided can be qualified as sufficiently “informative”. This result is echoed by institutional investors which were polled in the survey conducted as part of this Study[292], where only a quarter of the investors surveyed consider the quality of companies’ disclosure on corporate governance good or very good.

Looking more into details, companies disclosing general information tend to disclose explanations with a higher informative value than companies disclosing information on a provision-per-provision basis. This is very much the case for the group of mid-cap companies.

This observation suggests that companies disclosing comply-or-explain information on a provision-per-provision basis may be tempted to treat disclosure requirements more as a box-ticking effort. Indeed, in those markets were provision-per-provision disclosure is required, proportionally more deviations are disclosed without further explanation as to the reasons for deviation.

On balance, the provision-per-provision disclosure format tends to foster more extensive disclosure, though at the cost of a lower quality of the information provided.

3.2 Level of activity of institutional investors

The comply-or-explain approach traditionally relies on investors to monitor and enforce corporate governance codes. Shareholder participation should place corporate practices under closer scrutiny and lead to increased shareholder involvement against poor corporate governance standards. However, to make such a claim necessarily implies that shareholders place value on their right to voice opinions on key decisions at shareholder meetings, and exercise their rights. Moreover, to assert this claim is to advance the notion that shareholders have come to accept their role as an essential one in the greater regulatory attempt to scrutinise corporate practice.

The level of activity of institutional investors reported in Chapter IV of this study appears to be quite significant:

- Out of the sample of 100 respondents, the vast majority have a corporate governance or voting policy, and almost three quarters publicly disclose this information.
- The vast majority of respondents exercised their voting rights in the course of 2008. They usually vote on all or the largest proportion of companies in their portfolio as well as all or the biggest part of their assets under management. The results show that investors are active in challenging management decisions: over three quarters have used at least one vote against management in the course of 2008 as a result of inadequate explanations.
- Three quarters of respondents state that the implementation of their corporate governance or voting policy includes engagement. Engagement activities most usually take the form of a combination of activities (correspondence, conversations and meetings with the board, physical attendance at general meetings) rather than consisting of one single activity.
- Just over four-fifths of respondents report on voting and engagement activity, which can take the form of disclosing full voting records, summary reports, details on each vote cast against management or other formats.

However, those results should be treated with caution given the number of investors who have taken part in the survey. In fact, out of over 2,000 solicited institutional investors, only 100 - representing over EUR 400 billion of assets under management in the EU - responded to the invitation to participate in this study. The majority of investors who declined to participate in the study claimed the lack of resources or necessary expertise to fill in the survey questionnaire. The launch of the survey at the beginning of 2009, in the midst of the financial crisis, might also explain

[292] See Chapter IV-1.

the limited participation of investors. Therefore, it may indeed be noted that the respondents form a self-selecting group of institutions which actively participate in the corporate governance field.

The low response rate suggests that the institutional investor community consists of two distinct parts: a small active minority and a majority of more passive investors. The former tend to exercise their shareholder rights actively. They usually have a corporate governance policy, actively communicate and engage with companies, use their voting rights and often disclose the records thereof. The latter tend to be more reluctant to actively participate in the governance of companies they invest in. Moreover, due to the overall lack of disclosure from this category of investors, there is very little information about their actual practices in exercising their shareholder rights.

Passivity of investors in certain markets can be further confirmed by the data on voting results in Europe collected by RiskMetrics Group for the period from January 1st, 2008 to June 30th, 2008[293]. The report demonstrates that voter turnout rates, i.e. the total number of votes cast at a given shareholder meeting as a percentage of total voting rights, are still somewhat limited, at an average 60 percent[294]. The 2009 version of RMG's voting results report in Europe shows that the European average of voter turnout remains stable, at 61 percent[295].

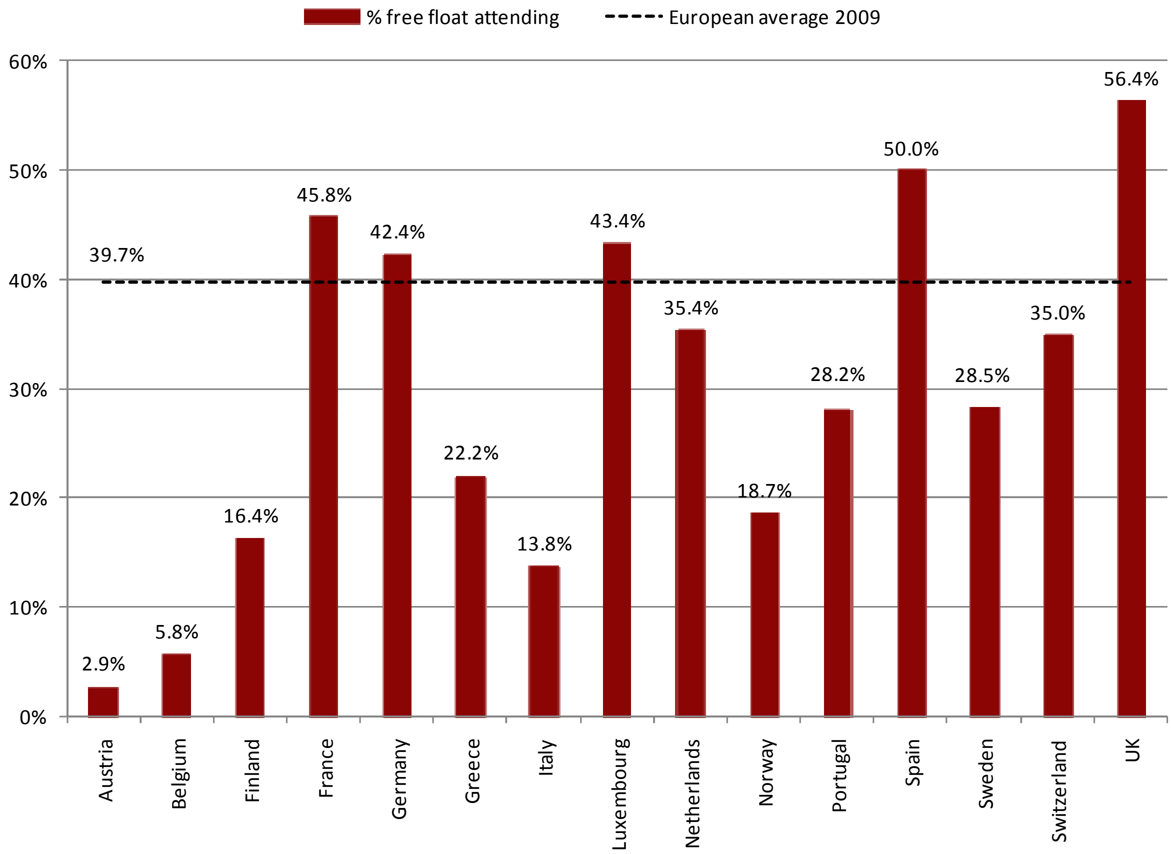
[293] RiskMetrics Group, *Voting results in Europe*, dated October 2008, available at: http://www.riskmetrics.com/docs/2008voting_ results_europe_report. The results were collected on a sample of 715 companies across Europe in the 17 following countries (including two non-EU countries): Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

[294] Note that because of varying disclosure practices, some of these figures should be interpreted with caution. In markets where companies are required to provide full information concerning voter turnout in capital and voting rights, the average attendance levels represent figures obtained for all companies. In other markets, information on attendance levels is often made available though not necessarily disclosed in a systematic fashion. As a result, the figures for some countries do not capture all of the companies included in the national index sampled for each market. Finally, in certain markets covered in this study, companies never provide disclosure of attendance rates at shareholder meetings. Due to the absence of any disclosure in these markets, average turnout figures have not been presented. These markets have not been taken into consideration when calculating average turnout figures for the aggregate European sample.

[295] RiskMetrics Group, *Voting results in Europe - Understanding shareholder behaviour at general meetings*, dated September 8th, 2009; available to RMG clients at: http://www.riskmetrics.com. The same cautious advice as for the 2008 figures apply for the 2009 report, although voting results disclosure practices have improved over a year, probably thanks to the impact of Directive 2007/36/EC on procedural shareholder rights. The results were collected on a sample of 698 companies across Europe in the 17 following countries (including two non-EU countries): Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

More interestingly, RMG's 2009 voting results report highlights the voter turnout of free float shareholders, and shows that, except in the United Kingdom, at most half of free float investors do exercise their voting rights at general meetings.

Proportion of free float investors voting at general meetings of European companies[296]
(13 EU Member States + Norway and Switzerland)



This figure, put in perspective with ownership structure data, suggests a lower voter turnout of free float investors in companies incorporated in Member States with traditionally concentrated ownership (Austria, Italy, Portugal, or to a slightly lesser extent Belgium and Nordic Member States). On the contrary, the voter turnout of free float investors seems more important in Member States with traditionally dispersed ownership (the United Kingdom, as well as France, Luxembourg, and the Netherlands, or to a slightly lesser extent Germany). This parallel is however inconclusive in the case of Spain, where an important free float voter turnout coincides with a significant level of ownership concentration at Spanish companies.

A parallel may be drawn between the free float voter turnout and the obligation (in France, the Netherlands and Portugal) or recommendation (in the United kingdom) for institutional investors to report on their voting policies and practices, one needs to keep in mind that such obligation or recommendation only applies to investors established in those countries, not to investors holding company stocks in these countries. A cross-examination with the level of national vs. foreign investment is therefore needed to put the relationship between free float voter turnout and voting disclosure obligations in perspective. With important domestic ownership (around 60 percent[297]),

[296] Source: RiskMetrics Group, *Voting results in Europe - Understanding shareholder behaviour at general meetings*, dated September 8th, 2009; available to RMG clients at: http://www.riskmetrics.com. As disclosure on the origin and categorisation of voters is not common practice in Europe and such information is scarcely available, the data presented hereunder was derived from aggregate voting results at European companies, with the assumption that all large shareholders (holding 5 percent of more of a company's share capital) voted their shares at general meetings.
[297] See Chapter I-2.4.

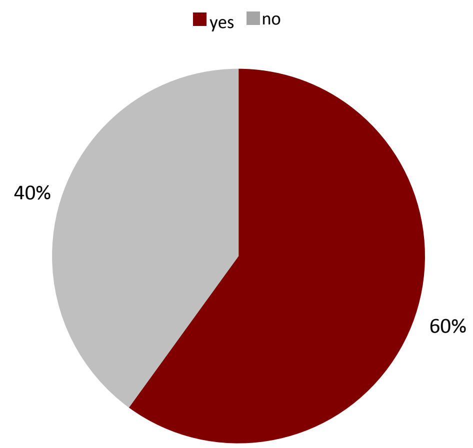
France and the United Kingdom show a high level of free float voting activity, probably indicating a correlation between the disclosure obligations - or recommendations in the UK – for local investors and actual voting activity at local general meetings. The below average level of free float voter turnout in the Netherlands still does not contradict the correlation as domestic investment is significantly lower in the Netherlands (around 30 percent[298]). Only the case of Portugal remains uncertain, as free float voter turnout is quite low although domestic ownership at Portuguese companies still stands by around 55 percent. This may however be the results of a lesser commitment of the Portuguese authorities to meeting their monitoring responsibilities on that matter, as shown in Chapter I[299].

Many influential organisations echoed the view that the investors are often inactive and that more engagement is required. For example, the issue regarding the passivity of some investors was mentioned in the ICGN statement as of March 23rd, 2009. The ICGN explicitly recognised that "many investors did not invest the time or resources to provide effective oversight"[300].The European Fund and Asset Management Association (EFAMA), as well as a number of national asset management associations also came to the same conclusion[301].

Nonetheless, the general observation is more one of passivity in engagement and voting. This situation is all the more significant in Member States where ownership of companies is concentrated, and where no framework to encourage transparency from investors has been put in place. Investors also often fail to simply disclose their corporate governance policies. A recent survey by Fair Pensions demonstrates that even in the United Kingdom, where voting policy disclosure practices are recommended, two-thirds of the pension funds still keep their voting results secret[302].

The lack of voting policy disclosure is also highlighted by the participants to the investor survey presented in Chapter IV. 60 percent of respondents point out that there is a call for a requirement for institutional investors to report on the implementation of their corporate governance policy.

Investors in favour of shareholders being required to report on the implementation of their corporate governance policy



[298] See Chapter I-2.4.
[299] See Chapter I-6.4.3.
[300] ICGN, Second Statement on the Global Financial Crisis, dated March 23rd, 2009; available at: http://www.icgn.org/files/icgn_main/pdfs/news/icgn_statement_on_the_financial_crisis_23_march_09.pdf.
[301] Notably the UK Institutional Shareholders' Committee, the German Bundesverband Investment und Asset Management, the French Association Française de Gestion Financière, the Polish Chamber of Fund and Asset Management, or the Swedish Pension Fund Association.
[302] *Responsible Pensions?, UK Occupational Pension Schemes' Responsible Investment Performance 2009*, dated April 2009; available at: http://www.fairpensions.org.uk/fairpensions_pdf/ResponsiblePensions_2009.pdf.

4 FIRST PILLAR OF AN EFFECTIVE COMPLY-OR-EXPLAIN SYSTEM: A GENUINE OBLIGATION TO COMPLY-OR-EXPLAIN

Applying the comply-or-explain approach

The first necessary condition for the comply-or-explain principle to properly function is "a real obligation to comply or explain". Although the concept of comply-or-explain had already been in place in many EU Member States, EU Directive 2006/46/EC introduced the requirement for companies to publish a comply-or-explain based corporate governance statement and to provide information on a series of corporate governance matters. Additionally, the Directive harmonised the responsibilities and liabilities of boards and auditors with regard to the publication of corporate governance statements.

This Directive has already been transposed in the majority of EU Member States (except in Belgium, Greece, and Malta) either directly in law, securities regulation or listing rules, or by reference in the law or securities regulation to a provision of the code itself mandating its application by way of comply-or-explain. Therefore, it can be concluded that the first requirement for the comply-or-explain to function has largely been achieved. Nonetheless, Member States that have not already transposed the requirements of Directive 2006/46/EC with regard to the publication of a corporate governance statement should strive to implement the Directive as soon as possible in order to create a level playing field for corporate governance reporting across the EU.

Complex listing situations

Nevertheless, the fact that the Member States have used different legal instruments (law, securities regulation, codes) to implement the requirement to publish a corporate governance statement can be a source of difficulty in the case of cross-border listing situations, whereby a company might find itself bound to comply either with several different codes or with none at all.

The majority of Member States do not have any provisions to remedy such situations. However, on March 23rd, 2009 the European Corporate Governance Forum proposed to introduce a set of new rules[303]:

- If the Member State of registered seat and the Member State of primary listing are different, the company should choose to apply the corporate governance code in either the Member State of its registered seat, or the Member State of its primary share listing.

- A Member State can only require that a company that is either registered in that Member State, or the shares of which are admitted to trading on a regulated market in that Member State, but which applies another Member State's corporate governance code, explains in what significant ways the actual corporate practices of that company deviate from those set out in the Member State's corporate governance code.

The proposed rules could be introduced as an amendment to Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions, and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings, as proposed by the European Corporate Governance Forum. It would ensure that a company complies with at least one code, by avoiding at the same time the potential requirement to apply two or more codes. Conventions or agreements between the EU and relevant non-EU countries have been negotiated to handle cases of complex listing situations involving listing in a non-EU Member State. A more systematic extension of these instruments with relevant non-EU countries on the model of the rules proposed by the ECGF could also be considered.

Another remediation to cross-border listing related issues could be the adoption of a pan-European corporate governance code. The EU considered this option when drafting its 2003 Action Plan but ruled it out at the time. According the 2002 Report of the High Level Group of Company Law Experts

[303] Statement of the European Corporate Governance Forum on Cross-border issues of Corporate Governance Codes, dated March 23rd, 2009; available at: http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf-crossborder_en.pdf.

which suggested the framework for the Commission's Action Plan, a pan-European code would indeed not significantly enhance the level of information provided to shareholders as such an instrument would either fit inadequately to the different legal systems and ownership structures across the Union, or develop into a much too general instrument to generate progresses. However, a significant minority of investors surveyed for this Study now support this solution (38 percent vs. 39 percent supportive of national codes). Although there is no clear-cut outcome of the survey on that matter, the situation would deserve to be monitored. Indeed, the option of a pan-European code might gain more traction and support over time, as corporate governance frameworks gradually converge across the EU.

5 SECOND PILLAR OF AN EFFECTIVE COMPLY-OR-EXPLAIN SYSTEM: A HIGH LEVEL OF TRANSPARENCY – THE NEED TO MONITOR

A high level of transparency, with coherent and focused disclosures, is the second essential condition for the comply-or-explain approach to work efficiently.

Boards have the main responsibility to produce a corporate governance statement explaining the areas of compliance as well as the reasons for non-compliance. However, given the recurrent agency problems as well as the inherent burden of disclosure for boards, it cannot be assumed that boards will voluntarily and systematically keep up to the required disclosure standards unless there is an efficient monitoring and enforcement system in place.

The comply-or-explain approach originated in the United Kingdom after the 1992 publication of the Cadbury Report. This approach therefore fit within the specific framework of the UK market of the mid 1990s: dispersed ownership structures and the presence of institutional shareholders, strong financial markets and influential financial press and community, common law and self-regulation traditions. These characteristics of the UK market resulted in a system where monitoring and enforcement responsibilities were largely left to boards of directors and shareholders.

With the development of corporate governance codes in continental European Member States in the late 1990s and early 2000s, the comply-or-explain approach spread across the region. Despite the structural differences between all Member States in terms of ownership concentration, institutional shareholding, financial maturity or legal frameworks, the comply-or-explain system has mainly been applied regardless of national specificities. Most importantly, monitoring and enforcement responsibility were for the most part left to boards of directors and shareholders in the vein of the UK model. Public monitors and specialised institutions are left with formal functions such as monitoring whether corporate governance statements have been published. Only in a few Member States do market-wide monitors go further and perform some kind of analysis of the quality of corporate governance statements and publish the results thereof. Auditors usually only validate the availability of corporate governance statements, although sometimes also verifying the accuracy of certain auditable information.

With over a decade of hindsight on comply-or-explain at pan-European level, it is clear that a number of issues need improvement, in the United Kingdom to the same degree as in continental Europe:

- the level and quality of explanations for deviations provided by companies is quite poor on a pan-European scale, as shown by the company practice analysis and highlighted by investors,
- the agency problems between the management and shareholders persist, and create a mismatch between the interests of the management and shareholders,
- only a minority of active shareholder conduct monitoring, without meaningful support of either the larger inactive majority of shareholders or public bodies,
- large shareholders are seen by an important minority of investors as having a negative influence on corporate governance practices, and

- monitoring and enforcement by shareholders may become an even more difficult issue in Member States with limited institutional ownership, where there is no counter-balance to the weight of block holders.

In the view of mitigating these issues and ensuring the proper application of comply-or-explain-based codes, boards of directors and shareholders need active support of other market participants well-positioned to execute monitoring activities, namely market-wide monitors and statutory auditors.

Enhancing of the role of market-wide monitors

The analysis of the practices of Member States demonstrates that the functioning of the comply-or-explain mechanism can be improved by granting more monitoring powers to market-wide monitors, be they securities regulators, stock exchanges or ad hoc committees. Provided that these monitors show sufficient independence, this practice can improve both the availability of information on company corporate governance practices and the quality of this information.

In many European Member States, market-wide monitors (financial market authorities or stock exchanges) or other specialised institutions (such as company registers or bodies controlling corporate reporting) are already responsible for verifying the availability of information disclosed in the corporate governance statement. In some instances, they are authorised to impose administrative or contractual sanctions in case the information is not provided, although examples of the use of sanctions are quite scarce. Formal verification of the publication of information is a valuable function of market-wide monitors because it ensures that the information is available to the market.

A formal check of the availability of information however falls short of addressing the core idea inherent in the comply-or-explain approach – the aim is not simply to provide information, but to provide qualitative and comprehensive input that can subsequently be used by market players to make informed decisions. The assessment by the market of the informative value of information disclosed by companies may become problematic, especially in Member States where shareholder engagement is limited. The simple availability check by market-wide monitors may therefore be necessary but not sufficient to ensure the proper functioning of the comply-or-explain approach.

In some EU Member States like Spain and Portugal, market-wide monitors perform an analysis of the informative value of corporate governance statements. This means that the monitor ensures that the company provides sufficient information and explains the reasons for deviations. Such information should enable shareholders to make an informed decision on the corporate governance issue in question. However, the monitor does not provide a business judgement about the content of the provision. The monitoring and enforcement activities range from engagement with individual companies regarding the content of the information disclosed, to the issuance of recommendations and analysis of the content of corporate governance statements provided by companies, combined with the publication of the results of such monitoring.

The analysis of the content of corporate governance statements is usually performed on a market-wide basis. The publication of the results of monitoring activities makes the information more easily accessible for all parties, and specifically facilitates the assessment of information by shareholders. Moreover, reports on monitoring tend to illustrate good practices and encourage companies to adopt similar conduct.

In addition, when companies' corporate governance statements are analysed at the explanation level, including cross-checks with other publicly disclosed documents, and when the results are presented on an individual basis, the market is provided with quality information corresponding with the purpose of the comply-or-explain approach. More importantly, the threat of negative publicity by market-wide monitors provides an incentive for companies to improve their corporate governance and disclosure practices. Reports providing an analysis of the explanations by companies also help to shift public focus from mere code compliance to the provision of meaningful explanations for deviations.

Therefore, national corporate governance frameworks could benefit from the appointment of a market-wide monitor, to be entrusted with the formal duty to monitor company compliance with the requirement to publish a corporate governance statement. Such a body could also to some extent provide a review of the veracity of the statement content via cross-checks with other publicly disclosed documents, as well as an assessment of the informative value of company corporate governance statements, on an annual basis.

Typically, the need for market-wide monitors may be more relevant in Member States lacking strong and active institutional ownership – like Greece, Lithuania, Slovenia, or Spain -, or when despite sizeable institutional ownership, the concentration of powers in the hands of important domestic shareholders prevents any meaningful action by institutional investors – like in Austria, Belgium, or Italy. Nonetheless, strong market-wide monitors have also proven efficient in enhancing corporate governance practices even in Member States with large and active institutional investors like France.

Ideally, market-wide monitors should play by the rules of the market to perform their monitoring tasks: the results of the monitoring should be made publicly available, on an aggregate basis and preferably also on an individual company basis, in order to highlight best practices and to push companies towards complete and meaningful transparency. Market-wide monitors could also use this type of publication as an informal threat revealing some companies' bad corporate governance behaviour ("name and shame"). Depending on the stringency needed to actively reach a satisfactory level of comply-or-explain disclosure, the use of formal sanctions could be considered. This type of sanction should however be used with caution and strictly in cases of unsuccessful use of informal measures.

Creating a standard and reliable framework for corporate governance reporting

For any monitoring and enforcement system to function, it is important, as a starting point, to ensure that the information about company corporate governance practices is available and of sufficient quality. This information can only then serve as a material for monitors and enforcers to analyse and take appropriate actions. As mentioned above, the formal requirement to disclose corporate governance statements is already in place at EU level. However, this does not guarantee that companies will provide a sufficient amount of reliable and qualitative information. The aforementioned findings of this Study show an overall quality issue of explanations for deviations by companies, as well as an issue concerning the reliability of the information disclosed. Chapter II highlights that the former issue is more prevalent when companies disclose comply-or-explain information on a general basis, while the latter issue is more prevalent for companies disclosing on a provision-per-provision basis. Hence, regulators and market participants face a double-edged issue – comprehensive disclosure of little quality with the provision-per-provision approach vs. probably incomplete disclosure with medium quality with the general approach.

A first approach could consist in focusing first and foremost on the issue of quality. The findings of Chapter II would hence suggest following general disclosure practices, for which explanations for deviation show an average higher informative quality (53 percent of specific or transitional explanations, vs. 36 percent in the case of provision-per-provision disclosure). The benefit of this approach is to begin from a slightly better starting point in terms of informative quality of the explanations. Better informative quality could be achieved by a greater scrutiny by market-wide monitors, and possibly by an increased use of "name and shame" strategies. The risk however is to encourage a tendency of companies to report only on elements they wish to disclose. This is best shown by the results obtained for France in this analysis: with no comply-or-explain obligation by the time the company analysis was performed for this Study, French companies scored the highest percentage of specific explanations in the sample, most probably because they disclosed only on elements for which they had good reasons to deviate from the reference code, while omitting others.

Regrettably, the issue of reliability of information disclosed on a general basis is valid regardless of Member States' ownership structure or their experience with the comply-or-explain mechanism. Indeed, even in Member States with a long experience of comply-or-explain, and strong and active institutional ownership, the issue of incomplete information of general disclosure seems persistent, despite efforts to enhance the system. The example of the United Kingdom is particularly relevant. In this Member State with the longest comply-or-explain reporting tradition in the EU, the difference in the number of explanations for deviations provided by the three companies disclosing on a provision-per-provision basis compared to those disclosing on a general basis is really significant: these three companies, representing 20 percent of the companies sampled in the UK, account for 46 percent of the explanations for deviations provided by UK companies in the sample. And when considering the number of code updates and the intense level of debate on corporate governance in the United Kingdom, there is no evidence that a purely incentive mechanism relying on general disclosure could ensure full transparency.

Additionally, the informative quality of explanations provided on a general basis, although higher than the one provided on a provision-per-provision basis, still only remains around 50 percent. The task to ensure quality is therefore far from being achieved.

Finally, the question of the relevance of quality reporting if it does not give a full overview of companies' practices will arise at some point.

An alternative approach would be to tackle the lack of reliability and comprehensiveness of information first. The example set by some Member States demonstrates that the reliability and comprehensiveness of information may be improved if the information is provided in a structured and standardised form. The analysis of the legal framework in EU Member States in Chapter I of this Study shows that a standardised form for corporate governance statements with the requirement to provide explanations on a provision-per-provision basis is mandated or recommended in Estonia, Hungary, Lithuania, Portugal, and Spain. The empirical company practice analysis presented in Chapter II of this Study demonstrates that companies in these countries[304] provide a greater average number of explanations than companies in countries without such a system. Additionally, another 33 companies in various Member States voluntarily disclose on a provision-per-provision basis. In most of these countries, notably in Italy, Luxembourg, the Netherlands, Poland and, the UK, companies disclosing on a provision-per-provision basis, disclose a higher number of deviations as their counterparts disclosing only general information. Therefore, whether they are obliged or recommended to disclose on a provision-per-provision basis, or whether they do this on a voluntary basis, companies disclosing on a provision-per-provision basis list an overall higher number of deviations.

When information is provided in a standard form and on a provision-per-provision basis, the information is easier to search, process and compare. This creates a level playing field for investors to compare the corporate governance information both within the countries and across markets.

The use of a standard form for corporate governance statements could create the necessary conditions for monitors and enforcers to fully perform their responsibilities.

The use of a standardised form for corporate governance statement may however have a negative impact on the quality of information. As shown previously, although the provision-per-provision approach might represent a fairer view of company deviations from corporate governance codes, the average informative quality of the explanations for those deviations tends to remain below the average informative quality of general disclosure. Provision-per-provision disclosure with standardised forms may indeed encourage the use of formulaic explanations for deviations from the code provisions and lead companies towards a box-ticking approach.

To mitigate the quality issue of standardised reporting on a provision-per-provision basis, standard forms could be structured in a way to ensure that companies provide extensive information about essential elements of their governance structure, compliance with the reference code on a provision-per-provision basis, and explanations in cases of deviation. The standard corporate governance statement should contain information on the following issues:

- Shareholder rights including information on general shareholders meeting;

[304] The practices of Lithuanian companies were not analysed in the Study.

- Ownership and capital structure;
- Board of directors, management and committees;
- Remuneration (can also form a separate report);
- Risk management and internal control;
- Compliance with the reference code on a provision-per-provision basis and explanations in cases of deviation from the code provisions.

It is important to ensure that the standard form only serves as a guide for companies to structure their corporate governance statement, and does not encourage companies to provide standardised and formulaic responses. For example, it could be structured as multiple detailed headings under which companies could give freeform responses.

The preparation of corporate governance statements in such standardised forms would not necessarily imply a significantly higher burden for companies. On the contrary, it could provide them with a ready-made, user-friendly framework to apply. Once filled in for the first time, companies would only need to make minor adjustments to periodically reflect changes in their corporate governance structures and practices.

On balance, the results of the overall analysis conducted for this Study points to the need for regulators to foster complete and trustworthy disclosure by companies, while ensuring this objective does not jeopardise the quality of information provided. In this respect, provision-per-provision disclosure could constitute an adequate framework to achieve this dual goal.

Extending the role of statutory auditors

Directive 2006/46/EC requires that statutory auditors undertake a formal monitoring of the compliance with the requirement to publish a corporate governance statement. This requirement applies whether or not the statement is published as part of the annual report or in a separate document. As a result, statutory auditors in all Member States should be obliged to perform the assessment of availability of information. Some Member States[305] have however not yet implemented the Directive. This issue is being addressed by the first recommendation of this Study.

However, the Directive strictly provides minimal harmonisation of the role of auditors in terms of monitoring and enforcement of comply-or-explain based corporate governance codes. In some Member States[306], the role of auditors is extended to include the verification of the accuracy of certain facts disclosed in the statement, and whether the statement is consistent with the rest of the audited information. The information to be verified is usually strictly of a factual nature, and does not require the auditor to make a value judgement. The practice of auditing factual aspects of corporate governance statements could usefully be extended to other Member States, in order to provide shareholders with the assurance that the information is accurate. Corporate governance statement audits should certainly only be limited to factual elements of corporate governance (e.g. remuneration details, board and committee meetings, existence of performance evaluations, use of external consultants to the board, etc.). The involvement of auditors should however be avoided in any issue open to interpretation, which should remain the responsibility of the board and the interpretation of the market.

A standardised methodology for auditors to perform their check of corporate governance statements could be developed to facilitate the comparability of company assessments. Shareholders should in any case be informed of the methodology used by auditors in performing their accuracy assessments.

[305] Belgium, Greece, and Malta.
[306] For example, in the United Kingdom, auditors verify if the corporate governance statement reflects the company's compliance with nine provisions of the Combined Code – mainly relating to audit committees - and have to report if it does not.

The underlying rationale of all the aforementioned suggestions, from enhancing the role of market-wide monitors and auditors, to creating a standardised and reliable framework for company reporting, is certainly not to put extra burden on the shoulders of companies, monitors or auditors, nor to create a compliance-driven framework that would be harmful to the spirit of the comply-or-explain mechanism. Rather, the ultimate goal is to provide shareholders with an enhanced structure of comprehensive and qualitative disclosure enabling them to play their monitoring role and exercise their responsibilities as final beneficiaries of corporate governance disclosure.

6 THIRD PILLAR OF AN EFFECTIVE COMPLY-OR-EXPLAIN SYSTEM: HOLD BOARDS EFFECTIVELY ACCOUNTABLE

The previous section advocated the enhanced role that market-wide public monitors and auditors should play in monitoring and enforcement of corporate governance codes. Nevertheless, their activities are seen more as creating the conditions for shareholders to exercise their monitoring and enforcement responsibilities. As owners of companies, shareholders are the best placed to monitor corporate governance arrangements made by boards of directors, and hold them effectively accountable therefor.

6.1 The existence of sufficient shareholder rights

In order to effectively monitor board decisions, shareholders need to be granted adequate legal rights.

Compared to their US counterparts, shareholders of EU-domiciled companies enjoy a wide range of fundamental rights in their capacity as ultimate owners of companies. These rights commonly include the right to appoint and dismiss board members, to appoint the auditor, to approve the annual report and accounts, and to decide on profit distribution.

These rights, mainly rooted in national laws, have been strengthened in recent years at the EU level. For example, two EU Recommendations on executive remuneration[307] advocate shareholders' right to approve the companies' executive remuneration policy at general meetings.

Another significant step was the adoption of Directive 2007/36/EC[308]. The Directive deals mainly with procedural rights in terms of timely access to relevant information ahead of the general meeting, participation in the general meeting, and distance voting. It also aims to abolish share blocking requirements and introduces minimum standards for the rights to ask questions, put items on the general meeting agenda, table resolutions, and call an extraordinary general meeting.

At the drafting date of this Study, limited information was available on the level of implementation of the Directive[309]. Yet, procedural rights of shareholders have been the focus of Member States and the European Union for some time, and, although technical hindrances still exist in various Member States, their future implementation is expected shortly.

However, shareholder rights directly related to the comply-or-explain system could be further enhanced by ensuring that the general meeting becomes a forum where companies' corporate governance practices would be systematically discussed. Shareholders should be offered the

[307] Commission Recommendation 2004/913/EC on fostering an appropriate regime for the remuneration of directors of listed companies, dated December 14th, 2004; available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:385:0055:0059:EN:PDF; Commission Recommendation 2009/385/EC complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies, dated April 30th, 2009; available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:120:0028:0031:EN:PDF.

[308] Directive 2007/36/EC of the European Parliament and of the Council on the exercise of certain rights of shareholders in listed companies, dated July 11th, 2007; available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:184:0017:0024:EN:PDF.

[309] Transposition deadline was set on August 3rd, 2009. Further information gathered after the drafting date of this Study show that only Bulgaria and Poland notified transposition by the transposition deadline, while Germany and the United Kingdom had adopted measures without formally notifying the European Commission. As of September 10th, 2009, RiskMetrics Group identified 11 Member States having adopted the necessary changes: Austria, Bulgaria, Denmark, Finland, Germany, Ireland, Lithuania, Poland, Romania, Slovenia, and the United Kingdom. Additionally, EEA Member State Norway also transposed the Directive.

opportunity to express their opinion specifically on corporate governance arrangements made by company boards.

Currently, shareholders can provide their opinion on companies' corporate governance practices via the vote on the annual report and accounts, or via the election of directors. However, such a vote does not allow shareholders to voice a differentiated opinion as regards companies' corporate governance practices. The approval of annual accounts is a very important decision in corporate life which serves as a basis for the profit distribution within the company. Likewise, director elections bring into play a number of leadership issues that go beyond corporate governance as such. Thus, shareholders might not wish to withhold the approval of annual accounts or counter the election of one or more director for the sole purpose of expressing dissatisfaction with the content of the corporate governance statement. As a matter of fact, RiskMetrics' 2009 voting results report shows that over a sample of 698 companies, not a single annual report/accounts or profit allocation proposal was voted down in 2009[310], and only 12 director proposals were rejected[311]. It is likely that shareholders resent from using those instruments to voice their opinion on companies' general corporate governance practices as it would send a message that might appear as too strong and not targeted enough on corporate governance as such.

Shareholders should instead be guaranteed that company general meetings also be a forum for discussion specifically on corporate governance practices. Depending on local legal and business practices, different instruments may be used to reach this objective: put the discussion of the corporate governance policy or statement on the general meeting agenda, introduce an advisory vote on corporate governance policy or statements, or even introduce a mandatory vote. Some of these options may however not be implementable in every Member State: some might not know of advisory votes; in some others, the inclusion as an agenda item might not guarantee a constructive discussion at the general meeting. A mandatory vote on the matter may also have complex legal implications, namely in terms of obligations resulting from a rejection vote, and could lead to additional hurdles in companies' current affairs. Most Member States could therefore favour either of the two first options, but the third one, or even a mix of different options is also possible depending on local practices. But whichever option is chosen, the ultimate objective is to enable shareholders to annually assess corporate governance policies and practices of companies they invest in, and voice their opinion in order to ensure dialogue between shareholders and companies.

Since the introduction of advisory or mandatory votes on remuneration in Denmark, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom[312], it is clear that companies are sensitive to negative votes on remuneration. Faced with a potential rejection of a proposal, they tend to engage in discussions with shareholders and change undesirable practices. Similarly, the discussion on corporate governance statements could serve as a device to enhance dialogue between companies and investors on the full range of governance-related issues, as it is the case in the Netherlands. Besides, it would enable companies to get the shareholder input on their own practices they often claim to miss.

[310] No rejection over 1294 proposals in total. Average level of dissent (vote against and abstention) for Europe on the matter: 1.2 percent (1 percent in 2008).

[311] 12 rejections over 2134 proposals in total (11 rejections coming from France). Average level of dissent (vote against and abstention) for Europe on the matter: 3.7 percent (3.9 percent in 2008).

[312] And recently as a possibility in Germany, see Chapter I-3.2.

6.2 The sufficient exercise of shareholder rights

Creating a framework for shareholder reporting

The EU has so far focused on providing shareholders with sufficient rights while less action has been dedicated to the question of how to encourage shareholders to use their rights. Although shareholder responsibilities was one of the medium-term objectives of the European Commission's 2003 Action Plan, the indecisive support for European action at the time has led the Commission to delay action on the matter.

As seen in section 3.2 of this Chapter, shareholders can be reluctant to use their rights. This means that monitoring and enforcement by shareholders might not be sufficient to ensure the proper functioning of the comply-or-explain system. Taking the aforementioned arguments into account, significant improvements could be realised in the future by ensuring that shareholders do use the rights with which they have been provided, or are incentivised to do so. In order for the whole comply-or-explain based system to function properly, and in order for all the suggestions developed above to reach their full potential, responsibility needs to be taken by all end-users of corporate governance: shareholders are and will remain the cornerstone of a well functioning comply-or-explain-based corporate governance system.

The disuse of shareholder rights can be attributed to a variety of factors. These factors include concerns as varied as the required time commitment on the part of senior management, the barriers to the exercise of governance rights, and the limited impact that individual shareholders can hope to have on voting outcomes. Additionally, as noted in the recent *Walker Review* of the Combined Code, "the absolute return that can accrue to investors from engagement initiative is not measurable, not least because there are so many other drivers of performance" [313].

From a macro-economic viewpoint, the situation can be analysed as a market failure due to the free-rider issue: shareholders are not a homogeneous group bearing the same interests or commanding the same resources. As highlighted in this Study, even among institutional investors, the implementation of a strong corporate governance system faces a structural free-rider issue. Monitoring and enforcement activities can be understood as a public good. Economically, once the investment to create a public good has been made, its consumption by an individual does not reduce the availability of the good for a third-party, and no one can effectively be excluded from using the good. Therefore, once the monitoring and enforcement activities have been performed by one monitor, others can enjoy or "free ride" on the results of these activities without making any additional investment. This in turn, reduces the incentive for the first monitor to invest in further monitoring and enforcement activities. As argued by economist Vilfredo Pareto, free-riding leads to inefficiencies in the system as a whole.

Applied to corporate governance, the free-rider issue materialises in a situation where very few investors have sufficient self-interest to dedicate resources and time to monitoring, and subsequently validating or sanctioning corporate governance practices. Large investment or pension funds, as owners of significant stakes in a large number of listed companies around the globe, cannot easily sell large stakes without having an impact on the market and hence damaging their own holdings. For them, careful monitoring, meaningful engagement, and voting can be the most cost-effective actions in terms of return on their own investments. However, a majority of investors devote few financial means and little time to these activities, thereby enjoying the overall improvement of corporate governance practices resulting from the common effort of the active minority without contributing to it. Such an attitude, in addition to deterring the efforts of the active minority and discouraging it to go further in monitoring, engagement and voting, leads to an overall slow-down of the improvement in corporate governance practices.

Therefore, the free-rider problem and lack of incentives might prevent shareholders from exercising the rights they are granted. This demonstrates that merely providing rights to shareholders might not in itself lead to a significant increase of shareholder involvement in monitoring and enforcing

[313] David Walker, *A review of corporate governance in UK banks and other financial industry entities*, paragraph 5.18, dated July 16th, 2009; available at: http://www.hm-treasury.gov.uk/d/walker_review_consultation_160709.pdf.

corporate governance codes. Some further action in this respect might in fact be needed to solve this market failure.

This market failure could be partially addressed if institutional investors held much more concentrated portfolios, enabling them to hold more significant absolute stakes in a smaller number of companies. This would encourage those investors to take a more active role in monitoring companies in which they invest, as monitoring benefits would potentially outweigh monitoring costs for them. However, this concentrated investment strategy entails consequences outside the scope of corporate governance and monitoring per se, which may eventually thwart the objective of increased engagement. Additionally, such a strategy might not be advisable for smaller investors, as either concentration levels could be too risky or individual stakes would still be too small to make active monitoring financially attractive. Finally, even though the concentrated investment strategy might foster increased monitoring by investor choosing this method, it will not fully resolve the free-rider issue as long as some investors continue to hold diversified portfolios. Therefore, although the merits of concentrated investment strategy could be further explored, other means should also be examined to tackle the free-rider issue at its root, i.e. that all shareholders do not participate in monitoring company practices.

Indeed, this question is becoming a central point of discussion. As noted by the ICGN in its March 2009 second statement on the global financial crisis, “shareholders must recognise that they should use their share-ownership rights responsibly in the interest of creating long-term value for their beneficiaries. If they do not act responsibly their rights will be at risk and their case for strengthened rights will be undermined”[314]. In a recent statement, the OECD also states that one of the most urgent steps to take now is to “act on the need for shareholders to be more active”[315]. The full awareness of their responsibilities by shareholders is a prerequisite for the system to function properly. In light of this situation, a number of market actors are now urging all institutional investors to take full responsibility in terms of active communication and engagement with companies, in order to improve the comply-or-explain-based system of corporate governance in Europe. Amongst the suggestions gaining growing support, is the idea of creating a framework for institutional investors to disclose the corporate governance policy governing their investments, and to report on their communication and engagement with companies. This idea is supported by a number of asset management associations, at national and European level[316]. It should also be noted that other voices outside the strict scope of corporate governance, like the European Sustainable Investment Forum (Eurosif)[317] and the United Nations Principles for Responsible Investment[318], advocate the same ideas.

As the High Level Group of Company Law Experts noted already in 2002, “good governance of institutional investors requires disclosure to their beneficiaries of their investment and voting policies, and a right of their beneficiaries to the voting records showing how voting rights have been exercised in a particular case” [319]. However, the Group considered a mandatory requirement for institutional investors to use their voting rights as unnecessary, if not counter-productive, as experience has partly shown in the United States. These propositions were incorporated by the European Commission as medium-term objectives in its 2003 Action Plan: “institutional investors should be obliged: a) to disclose their investment policy and their policy with respect to the exercise of voting rights in companies in which they invest; and b) to disclose to their beneficial holders at their request how these rights have been used in a particular case. Such requirements

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[314] http://www.icgn.org/files/icgn_main/pdfs/news/icgn_statement_on_the_financial_crisis_23_march_09.pdf.
[315] Statement by Mats Isaksson, Head of Corporate Affairs at the OECD, dated June 17th, 2009; available at: http://www.oecd.org/document/49/0,3343,en_2649_34813_43063537_1_1_1_1,00.html.
[316] Notably the German Bundesverband Investment und Asset Management, the Polish Chamber of Fund and Asset Management, or the Swedish Pension Fund Association, as well as the European Fund and Asset Management Association.
[317] According to Eurosif, “European institutions should introduce a mandatory Statement of Investment Principles (“SIPs”) for Investment Funds in which trustees would state […] their policy in relation to the exercise of the rights (including voting rights) attached to investments”, press release dated April 16th, 2009 ; available at: http://www.eurosif.org/content/download/1362/7715/version/2/file/018_Eurosif_Public_Policy_Position_Paper_PR_April2009.pdf.
[318] The United Nations recommend that investors “exercise voting rights or monitor compliance with voting policy (if outsourced)” and “Disclose active ownership activities (voting, engagement, and/or policy dialogue)”; copy of the principles available at: http://www.unpri.org/principles.
[319] Final Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe, dated November 4th, 2002; available at: http://ec.europa.eu/internal_market/company/docs/modern/report_en.pdf.

would not only improve the internal governance of institutional investors themselves, but would also enhance participation by institutional investors in the affairs of the companies in which they invest"[320]. In 2006, the European Commission launched a survey that showed indecisive results concerning the support of a mandatory framework of voting policy reporting by investors[321].

However, a mandatory framework of voting reporting has been implemented in a number of Member States, either in law (France, the Netherlands, and Portugal) or in the corporate governance code (the United Kingdom)[322]. In this context, it comes as no surprise that institutional investors domiciled in these countries show a significantly higher level of voting activity[323]. Thus, the transparency requirement seems to be an effective tool to incentivise institutional investors to make an active use of their voting rights and mitigate the market failure of free-riding. This suggestion would improve disclosure standards on monitoring activities for all EU-registered institutional investors. Furthermore, it would also be relevant in Member States where investor disclosure systems are already in place, as evidence suggests that even in those countries, a significant proportion of institutional investors fail to report in detail on their voting and monitoring activities.

It should be noted that the investor survey results presented in Chapter IV of this Study also reveal that the active minority of institutional investors feel that there is a need for an increased level of engagement in the corporate governance arena from the passive majority. As an example, they support the requirement that *all* institutional investors be obliged to report on the implementation of their corporate governance policy. Implementing the 2003 Action Plan objectives would hence encourage all institutional investors to take their responsibilities *vis-à-vis* their clients seriously, and ensure appropriate communication and engagement with companies, including by exercising voting rights and explaining the reasons for any deviations from investment or voting policies.

The institutional shareholder community will undoubtedly bear additional costs as a result of mandatory engagement and voting disclosure requirements. Today, these costs are borne by the minority of active investors, which may welcome to share the burden with other investors. Spreading the costs over all investors will help address the free-rider issue on this matter. Besides, costs need to be put in perspective with the benefits of raised corporate governance across the EU, and should remain within respectable boundaries as long as the framework provides sufficient flexibility.

Ensuring standards of shareholder reporting

Furthermore, some market participants argue for the development of codes of best practice for investors, based on codes of conduct already existing in a number of markets, and drafted by investor associations. These codes could be applied on a comply-or-explain basis. This would combine reporting on engagement and voting activity with a standardised and intelligible pre-set policy on which to report on a comply-or-explain basis. Such a system would still guarantee investors the crucial flexibility in terms of exercising their owner rights, including their voting rights. It would also ensure transparency towards their beneficial owners and towards companies which would benefit from increased transparency on corporate governance expectations and voting patterns of their shareholders.

The development of codes of best practice for investors has gained growing support amongst the main actors of corporate governance. It has notably been supported by the ICGN in its March 2009 statement on the financial crisis[324], as well as in its recent submission to the *FRC Review* of the UK Combined Code: "we believe there is a need for a clear and comprehensive code of best practice in

[320] Communication from the Commission to the Council and the European Parliament, *Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward*, COM (2003) 284, dated May 21st, 2003; available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2003:0284:FIN: EN:PDF.

[321] European Commission, DG Internal Market and Services, Consultation and hearing on future priorities for the Action Plan on modernising company law and enhancing corporate governance in the European Union, dated 2007; available at: http://ec.europa.eu/internal_market/company/docs/consultation/final_report_en.pdf.

[322] Especially in France, the Netherlands and the United Kingdom.

[323] As shown in Chapter V-3.2, and by the geographic spread of respondents to the investor survey (see Chapter IV–1).

[324] Point 4.6 of the ICGN Statement, dated March 23rd, 2009; available at: http://www.icgn.org/files/icgn_main/pdfs/news /icgn_ statement_on_the_financial_ crisis_23_march_09.pdf.

relation to the fiduciary duties of institutional investors, both asset owners and asset managers, setting out their responsibilities and proposing ways to meet them in spirit and in letter. […] We would suggest that such a code, which would cover both asset managers and asset owners, be premised on a 'comply (or preferably apply) or explain' approach".[325] Codes of conduct for investors, representing a market standard for investors in each Member State, should most preferably be developed by professional organisations of investors. These organisations are best placed to set the foundation of market driven principles for investor disclosure in each Member State, before it could evolve into more formalised, possibly European standards. In some Member States however, investor associations may be inexistent, too weak or insufficiently representative to set a market standard. In those instances, the development of a code of conduct might need the impulse of other actors, including regulators or ad hoc expert commissions.

The recent publication of the *Walker Review* to the Combined Code brought the issue under renewed focus. It suggests in a series of recommendations, to detach the provisions of Section 2 of the Combined Code targeting investors into separate "Principles of Stewardship" of communication and engagement, and further recommends that institutional investors commit, on their website, to follow these principles and report accordingly. Where investors would not be ready to commit to following the principles and reporting on them, "it should provide, similarly on the website, a clear explanation of the reasons for the position it is taking"[326]. The *Walker Review* hence clearly proposes a comply-or-explain-based system of reporting for engagement and voting, on the basis of a uniform standard established by the FRC, and promoted and monitored by the FSA.

These "Principles of Stewardship", as advocated by the *Walker Review*, already received support from the corporate world. In its submissions to both the *FRC Review* and the *Walker Review* of the Combined code, the UK Institute of Directors stated: "what is needed is an officially sanctioned code of best practice for investors – based on the 'comply or explain' principle – which can be used by beneficiaries to hold investors to account, both in terms of investor's own internal governance and the exercise of their ownership rights vis-à-vis investee companies. […] Over time, this could feed through to changes in investment behaviour amongst fund managers. It would also provide a reference point for new types of company owner, e.g. Sovereign Wealth Funds, regarding societal expectations of ownership behaviour in the UK"[327].

7 CONCLUSION

The comply-or-explain approach formally adopted by the European Commission in 2006 enjoys wide acceptance by the corporate as well the institutional investor community. However, its practical implementation suffers some deficiencies, mainly in the form of an unsatisfactory level and quality of information on deviations by companies and a low level of shareholder monitoring. These issues could be remedied by strengthening the role of market-wide monitors and statutory auditors, by creating a reporting framework to ensure comprehensive and qualitative disclosure by companies, and by developing a comply-or-explain regime for institutional investors. The comply-or-explain regime should not be abandoned. It should be strengthened.

[325] ICGN, *Letter to the Financial Reporting Council on their review of the Combined Code*, dated May 29th, 2009; available at: http://www.icgn.org/files/icgn_main/pdfs/comment_letters/20090529_icgn_comment_letter_on_cc.pdf.

[326] Recommendations 16 to 21 of the Review of corporate governance in UK banks and other financial industry entities, dated July 16th, 2009; available at: http://www.hm-treasury.gov.uk/d/walker_review_consultation_160709.pdf.

[327] Proposal 6 of IoD's submission to the Walker review, available at: http://www.iod.com/intershoproot/eCS/Store/en/pdfs/policy_ consultation_walker_ review.pdf and Proposal 6 of IoD's submission to the FRC review, available at: http://www.iod.com/intershoproot/eCS/ Store/en/pdfs/policy_ consultation_FRC.pdf.

Annexes

ANNEX 1: **METHODOLOGY**

1. Introduction

On August 2nd, 2008 DG Internal Market and Services commissioned a Study on the monitoring and enforcement systems concerning Member States' corporate governance codes. The objectives of the Study are:

- to describe the relationship, in the 27 Member States, between legislation and "soft" law (codes) in corporate governance;
- to examine the existing monitoring and enforcement mechanisms in the Member States as far as corporate governance codes are concerned and to evaluate their effectiveness;
- to obtain an impression of the companies' perception of the codes; and
- to evaluate the perception of shareholders as to the quality of companies' disclosure on the application of corporate governance principles and of explanations given where the company declares not to comply, and of their reactions to disclosure perceived as insufficient.

A consortium led by RiskMetrics Group submitted a bid on September 19th, 2008 for producing the Study.

The production of the Study was awarded to the consortium led by RiskMetrics Group on December 23d, 2008.

The present annex contains an overview of the methodology used in accordance with the terms of the bid. This methodology was further reviewed with and endorsed by the European Commission, among others during the kick-off meeting of January 22nd, 2009 and in a meeting organised to present the interim report on April 1st, 2009.

The *drafting date* of the Study, referred to in the text, corresponds to the delivery day of the draft final report to the European Commission on July 23rd, 2009. Unless mentioned otherwise, information is valid as of July 23rd, 2009. Additionally, complementary information has been introduced on a number of key points upon completion of the final report on September 23rd, 2009.

2. Legal analysis

The legal analysis contained in the Study has been drafted by RiskMetrics Group, on the basis of a legal review of the 27 EU Member States performed by Landwell & Associés and its network of European affiliates, based on their corporate governance expertise and experience.

Landwell & Associés created an analysis template for individual Member States following the structure laid down by the European Commission in the invitation to tender[328]. After discussions with RiskMetrics Group and the European Commission's approval, Landwell & Associés, circulated the analysis template to each of the 27 designated lawyers specialising in corporate governance issues in their respective Member States. Following a quality check from RiskMetrics Group and comments from the European Commission on the first drafts of each country analysis, Landwell & Associés and its network provided RiskMetrics Group with the final version of the legal analysis for each of the 27 Member States[329], on which RiskMetrics Group drafted Chapter I of this Study.

[328] Invitation to tender Nr MARKT/2008/23/F, p.18-19.
[329] The legal analysis for each of the 27 Member States can be found in Appendix 1.

3. Company practice

Coverage

Concerning the examination of a sample of companies, the methodology contained an original sample of 270 companies over 18 Member States, with 15 companies to be analysed per Member State. The objective was to have a sample containing:

- The first five listed companies by capitalization for each Member State
- 10 mid-cap companies

We have identified the sample based on all listed companies on a European stock exchange (based on Reuters database) on February 2 nd, 2009. Consequently:

- A ranking of top 5 companies (in market capitalisation) was produced per market of listing.
- Companies listed in a State which was not one of the 18 Member States as identified by the Commission were eliminated from this list.
- Companies with a free float below 1 percent were eliminated from this list as well.
- Companies which had completed an IPO and therefore had not yet been able to refer back to a full accounting year were eliminated from this list as well.
- The list of companies was then reclassified according to the country of domicile (a company with domicile in a particular country was analysed as a company from that country even if was listed in another country).
- The list of top market caps was capped at EUR 2 billion.
- Mid cap companies were identified as of a market cap below EUR 2 billion in a descending order.
- In so far a market had fewer than 5 companies with a market cap above EUR 2 billion, the remaining companies were analysed as a mid-cap companies.

Composition of the sample of companies (February 2 nd, 2009 – Reuters database)

	BELGIUM	
Large-cap companies	Mid-cap companies	Mid-cap companies
Anheuser-Busch InBev N.V.	Ackermans & van Haaren NV	N.V. Bekaert S.A.
Belgacom SA	Banque Nationale de Belgique SA	Sofina SA
Etn. Fr. Colruyt N.V.	Befimmo S.C.A.	Solvac SA
Groupe Bruxelles Lambert	Distrigaz S.A.	Telenet Group Holding NV
KBC Groep NV	Elia System Operator S.A.	Umicore

	BULGARIA	
Mid-cap companies	Mid-cap companies	Mid-cap companies
Blagoevgrad-BT AD Blagoevgrad	Druzhba Staklarski Zavodi AD Sofia	Purva investitsionna banka AD
Bulgaro-Amerikanska Kreditna Banka AD	Korporativna targovska banka AD Sofia	Sopharma AD Sofia
Bulgartabac Holding AD Sofia	Monbat AD Sofia	Sparky AD Ruse
Bulstrad Insurance and Reinsurance PLC	Neohim AD Dimitrovgrad	Zarneni Hrani Bulgaria EAD
Chimimport AD	Petrol AD	Zhelezopatna infrastruktura holdingovo druzhestvo AD Sofia

	DENMARK	
Large-cap companies	Mid-cap companies	Mid-cap companies
AP Moller Maersk A/S	Coloplast A/S	Genmab
Danske Bk	Dampskibsselskabet "NORDEN" A/S	Koebenhavns Lufthavne A/S
Novo Nordisk A/S	Danisco A/S	Rockwool International AS
TDC A/S	DSV A/S	Topdanmark A/S
Vestas Wind Systems A/S	FLSmidth & Co. A/S	William Demant Holding

	ESTONIA	
Mid-cap companies	Mid-cap companies	Mid-cap companies
AS Baltika	Harju Elekter	Silvano Fashion Group AS
AS Eesti Telekom	Kalev	Tallink Grupp A.S.
AS Ekspress Grupp	Merko Ehitus AS	Tallinna Kaubamaja AS
AS Starman	Norma	Tallinna Vesi AS
Eesti Ehitus AS	Olympic Entertainment Group AS	Viisnurk AS

	FINLAND	
Large-cap companies	Mid-cap companies	Mid-cap companies
Fortum Oyj	Kesko Oyj	Outokumpu Oyj
Nokia Oyj	Konecranes Oyj	Pohjola Pankki Oyj
Sampo Oyj	Metso Oyj	Rautaruukki Oyj
Stora Enso Oyj	Nokian Renkaat Oyj	Sanoma Oyj
UPM-Kymmene Oyj	Orion Corporation	Waertsilae Oyj Abp

	FRANCE	
Large-cap companies	Mid-cap companies	Mid-cap companies
Electricite de France S.A.	BIC SA	Television Francaise 1 SA
France Telecom SA	Bollore Investissement	Metropole Television S.A.
GDF Suez S.A.	PagesJaunes Groupe	Zodiac SA
Sanofi-Aventis	Neopost SA	Eurazeo
Total S.A.	Imerys	Vicat

	GERMANY	
Large-cap companies	Mid-cap companies	Mid-cap companies
Deutsche Telekom AG	Altana AG	HOCHTIEF Aktiengesellschaft
E.ON AG	Axel Springer AG	Lechwerke AG
SAP AG	Berlin-Hannoversche Hypothekenbank AG	Rhoen Klinikum
Siemens Aktiengesellschaft	Deutsche Postbank AG	SolarWorld AG
Volkswagen AG	Fresenius SE	TUI AG

	GREECE	
Large-cap companies	Mid-cap companies	Mid-cap companies
Coca-Cola Hellenic Bottling Company S.A.	ATEbank	Piraeus Bank S.A.
Demosia Epicheirese Elektrismoy A.E.	Ellaktor SA	Titan Cement Company S.A.
Greek Organisation of Football Prognostics S.A.	Emporike Trapeza	Trapeza Tes Ellados
National Bank of Greece SA	Hellenic Petroleum S.A.	Viohalco SA
Organismos Telepikoinonon Tes Ellados A.E.	Motor Oil (Hellas) Corinth Refineries SA	Vivartia S.A.

	HUNGARY	
Large-cap companies	Mid-cap companies	Mid-cap companies
MOL Magyar Olaj- es Gazipari Rt.	Allami Nyomda NyRt	FHB Jelzalogbank Nyilvanosan Mukodo Reszvenytarsasag
Orszagps Takarekpenztar es Kereskedelmi Bank Nyilvanosan Mukodo Reszvenytarsasag	Budapesti Elektromos Muvek NyRt	FOTEX Elso Amerikai-Magyar Vagyonkezelo Nyilvanos Mukodo Reszvenytarsasag
	Budapesti Ingatlan Hasznositasi es Fejlesztesi Nyrt.	Linamar Hungary Autoipari es Gepgyarto Nyilvanosan Mukodo Reszvenytarsasag
	Danubius Hotels Nyrt	Magyar Telekom Nyrt.
	EGIS Nyrt	Richter Gedeon Vegyeszeti Gyar Nyilvanosan Mukoedo Rt.
	Eszak-Magyarorszagi Aramszolgaltato NyRt	Tisza Chemical Group Public Ltd Co
		Zwack Unicum Likoripari es Kereskedelmi Nyilvanosan Mukodo Reszvenytarsasag

	IRELAND	
Large-cap companies	Mid-cap companies	Mid-cap companies
CRH PLC	Aer Lingus Group Plc	Glanbia PLC
Elan Corporation, plc	Allied Irish Banks PLC	Irish Continental Group PLC
Kerry Group PLC	Bank of Ireland	Irish Life & Permanent PLC
Ryanair Holdings PLC	DCC PLC	Kingspan Group PLC
	Dragon Oil PLC	Paddy Power PLC
		United Drug PLC

	ITALY	
Large-cap companies	Mid-cap companies	Mid-cap companies
Assicurazioni Generali S.p.A.	Acea S.p.A.	Fondiaria-SAI S.p.A.
Enel Spa	Banca Popolare di Milano SCaRL	IFIL Investments S.p.A.
ENI SpA	Banca Popolare di Sondrio Societa Cooperativa per Azioni	Italcementi - Fabbriche Riunite Cemento SpA
Intesa Sanpaolo S.p.A.	Buzzi Unicem S.p.A	Prysmian S.p.A.
Telecom Italia SpA	Fastweb SpA	Unipol Gruppo Finanziario S.p.A.

	LUXEMBOURG	
Large-cap companies	Mid-cap companies	Mid-cap companies
ArcelorMittal SA	BIP Investment Partners SA	Intercultures SA
RTL Group PLC	Cegedel SA	Luxempart SA
SES, Societe Anonyme	Compagnie de l'Occident pour la Finance et l'Industrie SA	Quilvest
	Espirito Santo Financial Group SA	Reinet Investments SCA
	Foyer	Socfinasia SA
	Gefinor SA	Societe Financiere Luxembourgeoise SA

NETHERLANDS Large-cap companies	Mid-cap companies	Mid-cap companies
ING Groep NV	Crucell N.V.	koninklijke Boskalis Westminster nv
Koninklijke KPN NV	Fugro NV	Koninklijke Vopak N.V.
Koninklijke Philips Electronics NV	Gemalto N.V.	Nutreco NV
Royal Dutch Shell Plc	Imtech N.V.	SBM Offshore N.V.
Unilever N.V.	Jetix Europe N.V.	Schuitema N.V.

POLAND Large-cap companies	Mid-cap companies	Mid-cap companies
Bank Polska Kasa Opieki S.A.	Asseco Poland SA	Getin Holding SA
Polski Koncern Naftowy Orlen Spolka Akcyjna	Bank Handlowy w Warszawie SA	Globe Trade Centre S.A.
Polskie Gornictwo Naftowe i Gazownictwo SA	Bank Zachodni WBK SA	Grupa Zywiec SA
Powszechna Kasa Oszczednosci Bank Polski Spolka Akcyjna	BRE Bank SA	ING Bank Slaski SA
Telekomunikacja Polska SA	Fortis Bank Polska SA	KGHM Polska Miedz S.A.

PORTUGAL Large-cap companies	Mid-cap companies	Mid-cap companies
Banco Comercial Portugues, S.A.	Banco BPI SA	REN - Redes Energeticas Nacionais, S.G.P.S., S.A.
Brisa - Autoestradas de Portugal S.A.	Banif SGPS, SA	Semapa-Sociedade de Investimento e Gestao, SGPS, S.A.
EDP - Energia de Portugal, S.A.	Martifer SGPS SA	Sonae SGPS, SA
Galp Energia SA	Mota-Engil, SGPS, S.A.	Sonaecom Sgps S.a.
Portugal Telecom SGPS, SA	Portucel-Empresa Produtora DE Pasta E Papel, S.A.	ZON Multimedia Servicos de Telecomunicacoes e Multimedia SGPS SA

SPAIN Large-cap companies	Mid-cap companies	Mid-cap companies
Banco Bilbao Vizcaya Argentaria SA	Bolsas y Mercados Espanoles, Sociedad Holding de Mercados y Sistemas Financieros, S.A.	Iberia Lineas Aereas de Espana SA
Banco Santander SA	Corporacion Financiera Alba, S.A.	Prosegur Compania de Seguridad SA
Endesa SA	Ebro Puleva	Sacyr Vallehermoso, S.A.
Iberdrola, S.A.	Gestevision Telecinco, S.A.	Sociedad Anonima Damm
Telefonica S.A.	Grupo Catalana Occidente, S.A.	Sos Cuetara, S.A.

SWEDEN Large-cap companies	Mid-cap companies	Mid-cap companies
H & M Hennes & Mauritz AB	AB Industrivaerden	L E Lundbergforetagen AB
Investor AB	Electrolux AB	Lundin Petroleum Ab
Nordea Bank AB	Holmen AB	Meda AB
Telefonaktiebolaget LM Ericsson	Husqvarna AB	Ratos AB
TeliaSonera AB	Investment AB Kinnevik	SSAB Svenskt Staal AB

UK Large-cap companies	Mid-cap companies	Mid-cap companies
AstraZeneca PLC	Amlin plc	Pennon Group Plc
BP PLC	Balfour Beatty PLC	Tate & Lyle PLC
GlaxoSmithKline PLC	Home Retail Group plc	Thomas Cook Group plc
HSBC Holdings PLC	ICAP Plc	Vedanta Resources plc
Vodafone Group PLC	Intercontinental Hotels Group PLC	Whitbread PLC

Company analysis - process

The analysis of the companies is based on data sources which are publicly available: articles of association, annual reports and other company documents publicly disclosed, issued in the course of 2008.

- Each lead analyst allocated companies within the team and their analysis was performed, based on a pre-defined analysis grid agreed upon between the European Commission and RiskMetrics.
- Upon completion, the analysis was checked internally by the country team leaders. The results were compared with existing databases in RiskMetrics and a further check was made before the findings were sent out to the company.
- RiskMetrics reached out to each company analysed to verify the findings on the comply-or-explain principle as well as on the other sections relating to board elections, independence, audit committees and remuneration. To that effect a summary report was created and sent out by email with an accompanying letter explaining the European Commissions' research project. Companies were asked to check data for factual accuracy in order to ensure the highest quality of the overall results.
- The lead analyst received comments if any from the issuer and, after discussion with the project leaders, amended the company profile if appropriate. 36

percent of the companies in the whole sample replied and their comments were included in the results.

- The analysis was consolidated along with all company profiles in the country, to check for consistency and coherence across that country.

4. Company and director perception of corporate governance codes

Scope and context of the Study

Chapter III of the Study seeks to get an impression of the effectiveness of the codes through the perception of the companies.

Survey instrument

GUBERNA, member of ecoDa, agreed to draft the questionnaire for both ecoDa and BUSINESSEUROPE. The aim of the questionnaire was to achieve an overall impression of the perception on the corporate governance codes by companies. The first deadline given by ecoDa and BUSINESSEUROPE to respond was March 5th, 2009 but it was extended until April 20th, 2009.

The survey contains a broad spectrum of important governance issues related to the codes. First, the associations were asked to **identify themselves** and indicate whether their answers were based on a public consultation, reflection meetings or hearings, public conferences/seminars, research input from a qualified selection of membership or the own opinion of the association itself. All public opinions and official papers that have been annexed to the questionnaires to substantiate their answers are identified at the end of this methodological review and available through hyperlinks or upon request.

In addition, respondents were asked to **identify the corporate governance code** they were referring to in the survey to emphasise the fact that the survey proceeds on asking questions related to this given code. An additional question on how long the code has been in operation was also inserted.

The questionnaire contains **6 major sections**:

- Objectives and effectiveness of the corporate governance code
- Structure of the code
- Content of the code
- Legislation and corporate governance codes
- The 'comply or explain' approach
- Costs of compliance with the corporate governance code

The first section seeks to find the initial **objectives of the codes**. Twelve general subjects, collected through research, were taken as basic objectives for corporate governance codes. Respondents needed to identify if they believed these subjects are also an objective of their code on corporate governance and to what extent these objectives have been reached by the code.

Further on, the **effects of the code** were measured for different topics relating to the **board, management, shareholders** and **stakeholders**. Respondents had to answer these questions in function of their board structure (two-tier boards, one-tier boards, or either).

Key governance topics (functioning of the board, roles and responsibilities, remuneration, etc.) were extracted and summarized in different tables. For example, for the board, fourteen topics were presented. Respondents were entitled to mark whether the code had a significant effect (significance of effect) on each of these topics. Furthermore, they were asked if they believed this effect was positive or negative (positiveness/negativeness of effect).

Section two refers to the **structure of the code** and asks for an overall assessment of the adequacy and clarity of the recommendations.

Section three regards the **content of the code.** It searches for the completeness of the codes in dealing with the appropriate topics. Next to an overall assessment of the code's content, respondents were asked the degree of completeness for twenty-five issues which are treated by most national codes.

Section four elaborates on the **complementarity between legislation and the codes**. It searches to analyse if the codes have significant impact on legislation.

The fifth section goes more in depth on the **'comply or explain' approach**. Different questions are asked on the flexibility of this principle and its consequences.

Finally the **costs of compliance** with the code in relation to the benefits are set out.

The identification of the topics and issues dealt with by the questionnaire is the outcome of international comparison of corporate governance codes, academic research, and best practice observations. GUBERNA, as a member of the Belgian Corporate Governance Committee, has a great deal of experience in this matter.

The questionnaire was established in English and approved by the European Commission before sending it to the respondents.

Sample selection and description

The questionnaire was set up and sent out among the **business associations** and **institutes of directors** in the Member States. To disseminate these questionnaires and increase the number of responses, BUSINESSEUROPE and ecoDa used their extensive network and contacted their members in the EU Member States to inform and request them to take part in the study. ecoDa also contacted institutes of directors which are not members of its confederation yet, as well as other organisations e.g. Stock Exchanges. All addressed associations were informed on the study and its objectives.

The use of both networks made it possible to have a broad view on the perception of codes by companies. National business federations and directors' associations from the EU contacted by BUSINESSEUROPE and ecoDa provided their perception of the codes on corporate governance by responding to the questionnaire. Through the efforts of both organisations the study covers the perception of a **broad spectrum of business leadership**, of both **non-executive** and **executive** directors.

For some countries (11) it was not possible to gather more than one response, resulting in one single opinion on the corporate governance code of these countries.

The questionnaires have been sent to the concerned associations by e-mail. To increase the degree of response, these organisations were contacted regularly.

Members from the subcontractors

ecoDa: Ten full members from the EU, one affiliated member being from a non-European country and anotheraffiliated member representing Chartered Secretaries),

1. British Institute of Directors (IoD), United Kingdom
2. GUBERNA, Belgium
3. Institut Français des Administrateurs (IFA), France
4. Institut Luxembourgeois des Administrateurs (ILA), Luxembourg
5. Finnish association of Professional Board Members (Hallitusammattilaiset ry), Finland
6. Instituto de Consejeros – Administradores, (IC-A), Spain
7. Czech Institute of Directors (CIoD), Czech Republic
8. Slovenian Directors' Association, Slovenia
9. Polish Institute of Directors (Polski Instytut Dyrektorów), Poland
10. Institute of Chartered Secretaries and Administrators (ICSA), United Kingdom
11. Croatian Association of Certified Supervisory Board Members (HUCNO), Croatia
12. Institute of Chartered Secretaries and Administrators (ICSA), United Kingdom

(all members from ecoDa (except the Croatian association, not concerned by the survey) have provided responses to the questionnaire).

In addition, three institutes of directors, not members of ecoDa, responded to the questionnaire:

1. Irish Institute of Directors, Ireland,
2. StyrelseAkademien Sverige, Sweden,
3. NedCommunity, Italy

BUSINESSEUROPE: 30 members from the EU.

1. Industriellenvereinigung - I.V., Austria
2. Fédération des Entreprises de Belgique - Verbond van Belgische Ondernemingen - FEB-VBO, Belgium
3. Bulgarian Industrial Association - Union of the Bulgarian Business – BIA, Bulgaria
4. Employers & Industrialists Federation Cyprus – OEB, Cyprus
5. Confederation of Industry of the Czech Republic
   Svaz průmyslu a dopravy České republiky – SPCR, Czech Republic
6. Bundesverband der Deutschen Industrie e.V. – BDI, Germany
7. Bundesvereinigung der Deutschen Arbeitgeberverbände e.V. – BDA, Germany
8. Confederation of Danish Industry – DI, Denmark
9. Confederation of Danish Employers – DA, Denmark
10. Confédération des Employeurs Espagnols – CEOE, Spain
11. Estonian Employers' Confederation – ETTK, Estonia
12. Mouvement des Entreprises de France – MEDEF, France
13. Confederation of Finnish Industries – EK, Finland
14. Hellenic Federation of Enterprises – SEV, Greece
15. Munkaadók és Gyáriparosok Országos Szövetsége - MGYOSZ (Confederation of Hungarian Employers and Industrialists), Hungary
16. Confederazione Generale dell' Industria Italiana – CONFINDUSTRIA, Italy
17. Irish Business and Employers Confederation – IBEC, Ireland
18. Fedil - Business Federation Luxembourg, Luxembourg
19. Lietuvos Pramonininkų Konfederaciją - Lithuanian Confederation of Industrialists – LPK, Lithuania
20. Latvijas Darba Deveju Konfederacija (Employers' Confederation of Latvia) – LDDK, Latvia
21. Malta Chamber of Commerce, Enterprise and Industry – MCCEI, Malta
22. Vereniging VNO-NCW, The Netherlands
23. Associaçáo Industrial Portuguesa – AIP, Portugal
24. Confederação da Indústria Portuguesa – CIP, Portugal

25. Polish Confederation of Private Employers Lewiatan - PKPP Lewiatan, Poland
26. Alianta Confederatiilor Patronale din, Romania – ACPR, Romania
27. Svenskt Näringsliv (Confederation of Swedish Enterprise) – SN, Sweden
28. Republikova Unia Zamestnavatelov (RUZ), Slovak Republic
29. Združenje Delodajalcev Slovenije - ZDS (Employers' Association of Slovenia), Slovenia
30. Confederation of British Industry – CBI, United Kingdom.

(21 members provided responses to the questionnaire)

Additional respondents contacted by ecoDa:

1. Spanish Stock Exchange Regulator, Spain,
2. A response based on a consultation of Spanish Listed Companies, Spain,
3. Association of Bulgarian Investor Relations Directors, Bulgaria
4. Union of Listed Companies ENEISET, Greece,
5. Corporate Governance Committee of the American Chamber of Commerce in Hungary in conjunction with the Hungarian Venture Capital Association, Hungary,
6. Austrian Federal Economic Chamber, Austria.

Input from 25 EU countries has been provided with a total of 42 responses receveid. Only Romania and Slovakia are missing.

Statistical analysis

The processing of the received questionnaires, as well as the first analysis of the survey and the data were done by GUBERNA in Belgium, in cooperation with the Institute of Directors (IoD) in the UK, both members of ecoDa.

To address our research questions we used the statistical program SPSS 15.0 for Windows as well as Microsoft Office Excel 2003.

Qualitative analysis

The analysis made by BUSINESSEUROPE and ecoDa reflects the responses received to the questionnaire.

For 15 Member States (Austria, Belgium, Bulgaria, Cyprus, Finland, France, Greece, Ireland, Italy, Luxembourg, Poland, Slovenia, Spain, Sweden and the UK) more than one respondent has provided responses to the questionnaire. In these cases, the results presented reflect the average of their responses.

Where results are evaluated as significantly above/below the median this means that they are 1.5 or more points distant from the median. If the results score below 1.5 points (in general 1 point) they are indicated as above/below the European median.

Differences of assessments between two respondents from the same country have been stressed when there is a gap of at least two points, considering that disagreement among respondents is observed.
When just one respondent replied to a question (the other did not reply or had no opinion) that response is given for the country for the concerned topic.
Each figure has been rounded up in order to represent them in the report in a similar way.

5. Investor perception of corporate governance codes

Design of the investor survey

The questionnaire to investors was designed by RiskMetrics and harmonised with the questionnaire to companies prepared by BUSINESSEUROPE and ecoDa to ensure a thorough and balanced overview. It was later reviewed by the ECGF and the European Commission and fully endorsed by the latter.

Survey distribution and investor responses

The questionnaire was emailed two times to over two thousand institutional investors, primarily based in Europe, whose portfolios include a significant proportion of shares issued by EU listed companies, listed in the RiskMetrics' database. The breath of RiskMetrics' database, compiled based on third party databases (mainly Thomson Financial and Bigdough) as well as its own database of clients, prospects and other business contacts, guarantees maximum representativeness of investors based in all Member States.

Pro-active follow-up via telephone call was conducted by RiskMetrics staff to European-based institutional investors with assets under management in excess of USD 10 billion.

In addition, RiskMetrics asked for responses from associations of institutional investors as well as associations of retail shareholders based in Europe. Besides, the invitation to participate in the survey was further promoted via investor publications and networks such as the ICGN.

One hundred survey responses were ultimately received. It is therefore important to note that the investor views outlined in the rest of this chapter reflect a self-selecting sample of investors, primarily those already involved in exercising their right to assess company corporate governance explanations.

List of insititutional investors and investor associations which contributed to the Survey*	
AEGON Asset Management UK	Henderson Glolbal Investors
AFG	Hermes Equity Ownership Services Ltd
AGICAM	Hermes Fund Managers
APG Asset Management	ING Investment Management
Association of British Insurers	JPMorgan Asset Management
Assogestioni	Legal & General Investment Management ltd
Aviva Investors (London Office)	Local Authority Pension Fund Forum
Blackrock	Mn Services
CalSTRS	National Association of Pension Funds
Capital Guardian International Inc	Natixis Asset Management
Credit Agricole Asset Management	Newton Investment Management
Credit Suisse Asset Management KAG	PGGM
Dexia Asset Management	Pictet Asset Management Limited
DIF Broker	Railpen Investments
DSW	Robeco
Dutch Shareholders' Organisation (VEB)	Sarasin & Partners
Elana Fund Management	SF City & County
F&C Investments	SNS AM
Fédéris Gestion d'Actifs	SPF Beheer
Florida State Board of Administration (SBA)	Standard Life Investments
Fortis Investments	Syntrus Achmea Asset Management
Gartmore Investment Management ltd	Threadneedle Asset Management
Governance for Owners	TIAA-CREF
Halbis Capital Management / HSBC Asset Management	UBS Global Asset Management

* The list only includes institutional investors and investor associations which accepted to be named as having contributed to the survey.

6. Conclusions and recommendations

Upon specific request by the Commission, all conclusions and recommendations were drawn up by RiskMetrics Group without further review by the subcontractors. The conclusions and recommendations are made on the basis of the findings from Chapters I to IV. To this end, RiskMetrics Group has also made reference to statements, comments and contributions made by regulatory bodies, financial market authorities, companies and shareholder trade bodies as well as some academics.

ANNEX 2: LIST OF ABBREVIATIONS

Country abbreviations:

AT: Austria
BE: Belgium
BG: Bulgaria
CY: Cyprus
CZ: the Czech Republic
DE: Germany
DK: Denmark
EE: Estonia
ES: Spain
FI: Finland
FR: France
GR: Greece
HU: Hungary
IE: Ireland
IT: Italy
LT: Lithuania
LU: Luxembourg
LV: Latvia
MT: Malta
NL: the Netherlands
PL: Poland
PT: Portugal
RO: Romania
SE: Sweden
SK: Slovakia
SI: Slovenia
UK: the United Kingdom

Other abbreviations:

ABI: Association of British Insurers (UK)
AFEP: Association Française des Entreprises Privées (France)
AMF: Autorité des Marchés Financiers (France)
BVI: Bundesverband Investment und Asset Management (Germany)
CMVM: Comissão do Mercado de Valores Mobiliários (Portugal)
CNMV: Comisión Nacional del Mercado de Valores (Spain)
Consob: Commissione Nazionale per le Società e la Borsa (Italy)
EC: European Commission
ECGF: European Corporate Governance Forum
EEA: European Economic Area (Iceland, Liechtenstein, and Norway)
EU: European Union
FMA: Financial Market Authority
FRC: Financial Reporting Council (UK)
FSA: Financial Services Authority (UK)
ICGN: International Corporate Governance Network
IoD: Institute of Directors (UK)
IZFiA: Izba Zarzadzajacych Funduszami i Aktywami (Poland)
MEDEF: Mouvement des Entreprises de France (France)
MFSA: Malta Financial Services Authority (Malta)
NAPF: National Association of Pension Funds (UK)
OECD: Organisation for Economic Co-operation and Development
UCITS: Undertakings for Collective Investments in Transferable Securities