CCBE RESPONSE TO THE GREEN PAPER ON THE EU CORPORATE GOVERNANCE FRAMEWORK

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The Council of Bars and Law Societies of Europe (CCBE) is the representative organisation of around 1 million European lawyers through its member bars and law societies from 31 full member countries, and 11 further associate and observer countries.

The CCBE submits the following comments in response to the Green Paper on the EU corporate governance framework.

OPENING REMARKS

The CCBE supports the initiative of the European Commission in launching a debate on issues relating to corporate governance. The financial and economic crisis has undoubtedly rekindled the need to broaden measures undertaken in this area.

However, the CCBE would like to point out that the involvement of shareholders in corporate social life should be a discretionary choice, and not an obligation. It is important that if investors wish to remain as passive shareholders they should not be obliged to take an active part in decision making. In this context, the CCBE has reservations about the Commission's opinion that *'the corporate governance framework is based on the assumption that shareholders engage with companies and hold the management to account for its performance. However, there is evidence that the majority of shareholders are passive and are often only focused on short-term profits.'* This assumption should at least be qualified, as a distinction should be made between minority shareholders (who may not wish to engage) and institutional investors. It is essential that there be equality of information for all shareholders - whether passive or active - so that they may make informed decisions without assuming the burden of "*active participation"* in the life of the company.

The CCBE also notes that some issues covered by the Green Paper such as the role of asset managers or proxy advisors, as interesting as they may be, fall more into the scope of regulation than corporate governance itself. These issues cause confusion between corporate governance of the company in which investments are made and corporate governance relating to shareholders.

In conclusion, the CCBE regrets that, although very much related to corporate governance, a number of issues have not been dealt with by the Commission, such as:

- The scope of authority of the Board of Directors: Should the Board, in order to fully guarantee its monitoring role have the discretionary power to summon members of the management to explain certain elements of their conduct?
- Preventing conflicts of interests within the Board: Should measures be taken to prevent for example, certain third parties having business relations with a company - suppliers, bankers, etc. - from serving on Boards of Directors?
- Directors' responsibilities: Should responsibility be collective or individual? Should a director be under a duty of care and clearly express his or her disagreement in case of a conflict with other Board members?

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

CCBE Response:

The emergence of companies whose market capitalisation is small, or even the introduction of such companies in 'organised' markets makes it necessary to develop rules of governance adapted to the size of listed companies.

Indeed, certain governance principles, such as diversity within Boards, are unsuitable as far as the organisation and requirements of smaller listed companies are concerned.

A system of thresholds relating to the number of employees and/or turnover could be useful for a tailored application of rules of corporate governance.

Aside from the size of the company, corporate governance could also be tailored according to the particular sector or geographical area in which the company operates.

However, the CCBE believes that there should be a basic set of rules applicable to all listed companies and from which no derogation should be permitted. For instance, the '*comply or explain*' principle should remain applicable to all listed companies, as well as principles of corporate social responsibility.

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

CCBE Response:

In the opinion of the CCBE, the Commission could suggest the implementation of corporate governance codes by unlisted companies. This approach would also be in line with the principles laid down by the European Commission under its Small Business Act.

Of course, this should apply only to companies whose turnover, number of employees and/or number of shareholders is significant. The approach adopted by the Commission should also be based on a voluntary implementation of corporate governance codes by unlisted companies.

BOARDS OF DIRECTORS

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

CCBE Response:

The CCBE considers it desirable to have a mandatory separation of the functions of the Chairman of the Board of Directors and of the CEO for listed companies having a significant size. Indeed, this separation contributes to greater legal certainty and effective monitoring of the general management by the Board. In this way the Chairman of the Board of Directors would have enhanced powers to monitor and control the general management, for which he/she should then report to the Board.

However, shareholders should be able to refuse such separation through a shareholders resolution in order to allow issuers the freedom to adapt to the specificities of their organisation and their activities.

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

CCBE Response:

In the opinion of the CCBE, it is essential that listed companies should publicly identify the skills being sought within their boards.

However, companies should be free to choose the qualities to which they intend to give priority within their boards, according to the particular characteristics of their organisations and their industry sectors. Companies should, if appropriate, be obliged to explain why they have not adhered to their previously declared policies.

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

CCBE Response:

The CCBE considers it necessary for listed companies to make public their gender diversity policy and to show in their annual report how they have applied such policy.

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

CCBE Response:

Insofar as the number of women serving on Boards among European companies is still low, the CCBE considers it desirable to promote greater representation of women on Boards.

The CCBE therefore favours the introduction of quotas in listed companies. These should be determined first at a relatively low and practicable threshold (20% for example), and then progress over time. The implementation of such quotas should be optional - on a *comply or explain* basis - during a transitional period of three years before becoming binding.

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

CCBE Response:

In principle, the CCBE is in favour of limiting the number of terms of non-executive directors, who usually already have another full-time occupation. Indeed, directors' availability is essential for the proper functioning of boards. The CCBE strongly believes that such limitation should only apply to listed companies.

The CCBE is nevertheless divided on the issue of the maximum number of mandates which should be imposed by law.

Some members argue that a restriction might deprive companies of the experience of an experienced professional with many mandates owing to a long career. Moreover, they find it impossible to decide on a maximum figure given the specificities of each company and the personality of individual directors (e.g. organisational skills, industry knowledge, etc.). This is why they consider that the EU should only introduce a presumption of unavailability after five combined mandates - in order to grant some flexibility to companies. Directors with over five mandates would then have to justify time spent in office as directors.

Other members however consider that companies are not strict enough towards passive directors, and that it is for legislature to fix rules. It is therefore suggested to:

- Recommend limiting the number of mandates that a director may hold in companies established in the European Union (general limit), to, say, five.
- Extend this restriction to all mandates held in corporations, whatever their legal form and wherever their head office.
- By way of exception, allow without limitation mandates held in companies belonging to the same group so that they would not be taken into account when assessing the general and specific limitations mentioned above.

In addition, all the members of the CCBE consider it appropriate that listed companies are required to publicly declare the availability and time that the duties of a non-executive director will require during the year.

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

CCBE Response:

Yes. Regular evaluation of the work of the Board and the intervention of external consultants are increasingly recommended by codes of corporate governance.

According to the CCBE, the evaluation of the functioning of the Board of Directors by an external evaluator should not be a compulsory requirement. This should be a simple option at the discretion of the Board or its committees, who should be given the necessary resources (including financial resources) to rely on external experts.

The CCBE believes that this evaluation could be carried out by corporate in-house auditors or corporate legal counsel, both of whom would already be familiar with the functioning of the company. However, it is imperative that they be subject to the same obligations of confidentiality as their fellow board members. To be truly effective, such an external evaluation should not be published and should even come under professional privilege/secrecy, which would prohibit its use for other purposes, for example in the context of judicial proceedings. Nevertheless, nothing would prevent a company from publicising the key findings and recommendations from the evaluation (in its annual report for instance).

(9) Should disclosure of remuneration policy, the annual remuneration report (a report on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors be mandatory?

CCBE Response:

Directive 2003/71/EC of the European Parliament and the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and European Regulation (EC) No. 809/2004 of the Commission implementing this Directive have increased the transparency requirement of these elements of Directors' remuneration.

An annual report specifically describing the policy of collective remuneration for executive and non-executives may increase transparency and limit potential abuse. Most CCBE members believe that this report should not be required to make reference to the individual remuneration of directors. Some CCBE members expressed a wish to see companies required to publish a ‘range’ within which an individual director's remuneration falls, to ensure that directors are not stigmatised, whilst fully informing shareholders and the market.

Moreover, the obligation to publish such a report should not bind only listed companies and should be extended to all Member States.

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

CCBE Response:

A Shareholders' vote on remuneration policies is at the heart of two fundamental principles: on the one hand, it is crucial not to create a relationship of conflict and distrust between shareholders and their executives due to their remuneration; and on the other hand, it is legitimate that shareholders should be fully informed of their executives' remuneration. In this context, some members of the CCBE consider that it should not fall to shareholders to vote on the remuneration policy for Directors. However, to ensure that Directors' remuneration is not set at the discretion of the Board, shareholders should nevertheless express their views on matters concerning the remuneration of Directors - in an advisory capacity only - in order to express their disagreement on the remuneration policy implemented should the case arise. Other CCBE members consider it necessary that the remuneration policy appears in a detailed report to be submitted for a mandatory shareholder vote.

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

CCBE Response:

Environmental and societal risks can be a considerable source of responsibility for issuers, and the management of the company should take responsibility in the first place.

In contrast, defining a corporate risk-management policy whether for financial or non-financial risks falls to the board.

In practice, the board cannot control every single decision of the management. However, to avoid that the management takes significant risks, it would be appropriate to state that the Board's duty, as part of its mandate to monitor the executive power is to:

(i) Identify corporate risks, including social and environmental risks

(ii) Implement an effective risk-management policy

(iii) Establish sufficient internal monitoring tools to prevent risk-management policy deficiencies

(iv) Take additional measures to verify selectively that these internal monitoring tools function well

(v) Report to shareholders on risk-management policy (including all the items mentioned from (i) to (iv) above).

This requirement should be construed as a procedural obligation so that the responsibility imposed on directors is not disproportionate, which might only serve to discourage some people from assuming the role of director.

(12) Do you agree that the board should ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile?

CCBE Response:

Yes. See answer 11 above. Internal control should be under the responsibility of the Board or the Chairman of the Board of Directors.

SHAREHOLDERS

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

CCBE Response:

In the view of the CCBE, it would be desirable to consider the regularity with which financial information is published, as this can encourage 'short-termism' attributed to investors. In addition, attention could be drawn to the current lack of accounting standards for valuing intangible assets, such as for instance "corporate human capital".

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

CCBE Response:

The CCBE considers that this is not an issue that relates directly to corporate governance. It is primarily a matter of regulating the activities of asset managers.

In any event, the CCBE does not consider it desirable to control the remuneration arrangement of asset managers. Investors and asset managers should be free to determine the incentive structures put in place in relation to performance achieved and risks undertaken.

However, investors (whether long-term or short term investors) must be fully informed of the policy and investment strategy followed by asset managers.

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

CCBE Response:

Yes. As mentioned in the previous answer, it is essential that investors receive full and accurate information on the strategy that the manager intends to implement.

The success of so-called 'ethical' funds (also called *'socially responsible funds'*), the investment strategies of which are based not only on quantitative criteria of profitability but also on qualitative criteria (investment in certain sectors, activities or developing geographical areas) show that investors may be attracted by motives other than simply short-term profitability.

Asset managers should report to investors – before the investors subscribe - their voting policies and communicate potential updates and report annually on how they have implemented these policies.

Where managers have not exercised these voting rights, they should be summoned to give investors reasons for this decision.

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

CCBE Response:

Again, the CCBE believes that this issue does not directly concern corporate governance but the regulation of asset managers.

Nevertheless, according to the CCBE, the existence of conflicts of interest between on the one hand an asset manager and on the other hand, another group company that has business relations with the entity in which such manager is investing, is likely to affect both the investment policy of the asset manager and the trade policy of the other company.

The principle of strict separation between the activities of trading securities and advisory activities within credit institutions already exists. However, the CCBE believes that the publication of potential conflicts of interests of an asset manager should be encouraged.

(17) What would be the best way for the EU to facilitate shareholder cooperation?

CCBE Response:

This question raises two distinct issues:

- *Cooperation between shareholders and the company*: the CCBE agrees with the Commission that shareholder participation in corporate life should be encouraged, especially in the context of transnational ownership. In this regard, posting online draft resolutions and publishing arrangements for shareholder participation is likely to increase the participation of foreign shareholders. In order to have them truly involved, information must be given not only in the original language of the company but also in a language commonly accepted by the financial community.
- *Cooperation between shareholders*: If the exchange of information relating to companies is to be encouraged, it should be noted that there are two limits. The first limit is practical, since shareholders do not have information on other shareholders (details, profiles, etc...). The second limit is legal, because for listed companies, exchange of information that takes the form of a common policy could be treated as 'acting in concert' with the consequences that that entails. In this regard, it is probably difficult to reach a European definition of the concept 'acting in concert' as whether this is the case will depend on an appreciation of the particular facts. However, it would be desirable, for the sake of legal certainty, to have a 'negative definition' of 'acting in concert' at the EU level, specifying situations which do not constitute 'acting in concert'.

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

CCBE Response:

The CCBE believes that this issue does not directly concern corporate governance, but rather the regulation of activities of proxy advisors. The European Commission could reflect on these activities as it did for rating agencies.

In any event, the CCBE considers it appropriate to regulate this activity further. Proxy advisors who send voting recommendations are exposed to a very large number of conflicts of interest due to their parallel activity of advising companies and also due to their links of interests with specific groups of shareholders..

It is also essential for proxy advisors to be transparent about the criteria used to analyse resolutions and issue voting recommendations. As the criteria used are numerous; transparency suggests that they should speak out publicly and in advance on the value attributed to each criterion, so that investors are able to see clearly what voting policies best fit their profiles and their interests. In this regard, it is also desirable to improve communication and exchanges between issuers and proxy advisors. In practice, it is not uncommon for proxy advisors to make voting recommendations against certain resolutions (probably because voting policies are pre-established by proxy advisors) while the issuer is able to justify the resolution submitted to the vote of its shareholders (who accept it insofar as the company is able to explain the reasons for the resolution).

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

CCBE Response:

The CCBE believes that proxy advisors should not be allowed to provide advice and make recommendations for the same company. The coexistence of analysis and advisory activities should nevertheless be permitted if the same company does not receive the two types of services, provided that for instance these two activities are not provided to two competing companies.

It is also important to promote dialogue between agencies and issuers to promote knowledge of the issuer by the advisor and prevent recommendations by proxy advisors from being manipulated and leading to disruptions on the market, which would be detrimental to the company, and ultimately to shareholders. As indicated in question 18, it would be appropriate to improve exchanges between issuers and proxy advisors.

This dialogue can develop through the introduction of the adversarial principle in developing recommendations: companies could require, if they so wish, to be warned in advance of negative opinions and to provide their comments. Dialogue can also arise through providing the issuer’s response to each opinion, or at least a link to the response.

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

CCBE Response:

Issuers may now have good knowledge of their shareholders through the reporting obligations of disclosure thresholds and declarations of intent.

To better understand their shareholders, they must resort to specialised procedures, such as the service TPI (*Titre au Porteur Identifiable* (identifiable bearer security)) in France, which is limited in the fact that they are only permitted to request a list of title holders from national custodians. A European provision authorising central custodians from Member States to send requests to all custodians throughout Europe would enable issuers to have a deeper understanding of their shareholders.

Custodians should be required to communicate, with remuneration being paid by the issuer, the following information:

- Name of title holder

- Nationality
- Address
- Quantity of securities held by the holder and, where appropriate, restrictions to which the securities are subject.

The introduction of such a mechanism, if it presents interests for the issuer, may not prove to have any structural impact on corporate governance. In practice, we currently see that the identification of shareholders is extremely expensive and that issuers use them less to maintain a close dialogue with their investors than to promote in a targeted way their strategies for dealing with activist shareholders.

To promote cooperation between shareholders, issuers might consider giving their shareholders an identification key with secure codes allowing them access to a discussion forum. This forum would allow investors to discuss company management and to access the same information subject of course to issues of secrecy of business affairs. This cooperation is also limited as far as 'acting in concert' is concerned as mentioned in Question 17.

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

CCBE Response:

Minority defence associations and proxy advisors have become over the years the true voice for minority shareholders. They allow them to benefit from better access to information and further promote their interests with controlling shareholders.

So that controlling shareholders do not have a disproportionate voice in the direction of the company, the problem is not actually to represent 'minority shareholders' as such, but to ensure that:

- All company directors have the responsibility to represent the collective interest of all shareholders, and not just one of them. In this regard, the best protection is the presence - at least proportionally to minority shareholders - of as many independent directors as possible, independent from company management, and above all from controlling shareholders.
- Minority shareholders vote to reduce absenteeism. The European legislature should encourage postal voting or through a proxy. Indeed, minority shareholders’ absenteeism allows some shareholders to exert *de facto* control over general meetings.

In any event, rights of minority shareholders should fall to Member States.

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

CCBE Response:

Related party transactions are likely to create conflicts of interest. Minority shareholders should therefore receive increased protection.

According to the CCBE, several measures would help to regulate related party transactions and risks they may cause:

- These agreements should be subject to prior authorisation before being concluded and any interested parties should not be able to take part in voting
- An independent expert should draft a report for the most significant transactions - it is not uncommon in groups of companies for significant transactions to be preceded by a fairness opinion delivered by an independent expert

Before adopting any measure on the matter, the European Union should ensure that rules governing related party transactions can be implemented in practice. These rules could at least be made by way of a Recommendation, which would allow Member States freedom to determine the practicalities within the framework.

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

CCBE Response:

It is desirable to promote staff participation in the capital so that it is not only a source of additional income for employees but also a way for issuers to have loyal and stable shareholders.

However, Member States should have the right to decide which measures should be taken.

MONITORING AND IMPLEMENTING CORPORATE GOVERNANCE CODES

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

CCBE Response:

The CCBE notes that codes of corporate governance are a source of soft law for issuers. It is also desirable that recommendations proposed by codes of corporate governance are applied voluntarily by listed companies. Such a solution gives companies the right to determine their governance system, by adapting to the specificities of their organisations and their activities.

In this context, the CCBE would suggest that each listed company should determine the code of corporate governance which it chooses to refer to in governance matters. However, the company would be perfectly free to depart from certain points of that code of corporate governance provided it explains the reasons which have led it not to comply with one or more recommendations and that it states which principles are established instead.

Many annual reports now contain explanations which, in formulaic wording ('*the company believes that it is not appropriate to comply with this provision*) do not really explain why companies have not chosen to comply with the relevant code of corporate governance. It would be desirable to ask organisations which are promulgating codes of corporate governance to provide examples of positive and negative justifications, to encourage companies to give more details about why they have departed from the rules of governance.

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

CCBE Response:

The CCBE does not consider it appropriate to give regulatory authorities the responsibility of verifying the information provided by issuers on corporate governance matters.

In France, the national securities and markets authority - *Autorité des marchés financiers* - publishes an annual report on corporate governance. This report provides details, from a limited sample of listed companies, about practices observed in corporate governance, and provides several recommendations.

For several reasons, it seems that a comprehensive approach would be the best option:

- First, it does not (and should not) fall to a regulatory authority to verify the application of non-binding rules contained in codes of corporate governance (or that this role should fall to organisations which are responsible for issuing these codes of corporate governance, and which would also monitor their proper implementation)
- Secondly, in case of a lack of transparency by an issuer in terms of its governance rules, there should be direct sanctioning by the market (especially by proxy advisors who would not fail to mention it in their recommendations)
- Finally, this approach would inevitably standardise systems of corporate governance, since statements of corporate governance would be submitted to a single supervisory authority for evaluation.

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