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Internal Market and Services DG

FREE MOVEMENT OF CAPITAL, COMPANY LAW AND CORPORATE GOVERNANCE
Company law, corporate governance and financial crime

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ADVISORY GROUP ON CORPORATE GOVERNANCE AND COMPANY LAW

MINUTES OF THE MEETING OF 28 APRIL 2009

(1) Introduction

The Commission welcomed the Members of the Group who attended the meeting. As it was the last Group meeting under the current mandate, the Commission expressed its gratitude to the Group for its valuable contributions throughout the four years of its existence. The input from the Members with different professional and national backgrounds has given the Commission a better understanding of problems and helped find solutions taking into account differing approaches. Two sub-groups had been created in 2007 to make the Group's work even more efficient. The contributions from Members were particularly valuable for the Communication on Simplification of company law, accounting and auditing, the impact assessment on a possible future directive on the cross-border transfer of the registered office and the draft proposal as well as the draft model articles of association of the European Private Company.

The Commission informed Members that the decision about a new Advisory Group would have to be taken by the new Commissioner. In case of a positive decision, the new expert group would probably not be operational before 2010 as the procedure for the establishment of an expert group and the choice of the members could take several months.

(2) Approval of the agenda

The agenda was approved.

(3) The EU response to the financial crisis, focusing on the corporate governance and company law aspects

The Commission informed the Members about the recent developments at the EU level in response to the financial crisis. In November 2008 the Commission mandated a High Level Group (chaired by Mr Jacques de Larosière) to prepare a report analysing the causes of the financial crisis and proposing recommendations on how to respond to the financial crisis. On the basis of the de Larosière report, presented on 25 February 2009, the Commission announced, on 4 March 2009, a Communication proposing a number of concrete measures aiming to reform the European financial system and an action plan for the Financial Services Sector. One of the proposed actions is the strengthening of the

2004 Recommendation on directors' remuneration and a new Recommendation on remuneration in the financial services sector. The Recommendations were to be published on 29/04/2009. The Commission thanked the Members of the Group who had submitted written comments on the subject. The Commission also informed the Group about the on-going work on the amendments to the Capital Requirements Directive (due for mid-June) and on a report on corporate governance in the financial institutions due for end 2009.

a) Recommendations

Several Members had questions or asked for clarifications on the Recommendations. Some of them said the Recommendations contained some vague terms open for judgement (e.g. 'underperformance', 'expertise', 'manifest misstatement', 'lack of conflict of interest') and it was not clear who should determine their meaning. In their view the Recommendations should use clearer terminology. A Member asked what was meant by 'some shares should be kept until the end of employment'. The Commission replied that this provision aimed to require companies to discuss this issue and include it in their remuneration policy, but left them the discretion on the exact policy choice. A Member said that in France it was the board of directors that decided on the amount of shares. In reply to a Member's question, the Commission informed that the Recommendation did not contain any additional provisions on the vote on remuneration policy. However, it required the members of the remuneration committee to be present at GM when the issue is discussed to reply to questions and give explanations. In reply to another Member's question the Commission replied that the Recommendations will have no impact on collective agreements.

A Member informed the Group about the recent developments on directors' liability in Germany and was rather critical about the proposal that the variable pay was kept until the end of employment. This would only result in the increase of the fixed pay component.

Some Members asked about the role of institutional investors. The Commission said that they had an important role to play in controlling the managers and should be encouraged to participate in GMs and use the voting rights. A Member said that the legislation may have a limited impact as some institutional investors had an internal policy not to intervene in the strategy of a company. Another Member said that the crucial issue was to ensure transparency, i.e. that the investors were informed when there is a risk, so that they knew that is important to vote. This Member also said that there was no one model of remuneration policy that would suit all. It had to be adjusted to the business model of a specific company.

A Member stressed that it was important that the Recommendations were applied not only to the mother company, but to the whole group. The Commission confirmed that this was the case.

Another Member underlined that the different approach taken by the Commission to the financial services sector and to the other sectors should not result in neglecting the non-financial sectors.

b) Corporate Governance in the financial institutions

The Commission informed the Members about its on-going work on the report on corporate governance practices in the financial institutions, due for end 2009, and asked Members' views on this issue.

One Member pointed out that this crisis did not result from failing CG rules and principles, but that more emphasis should be put on the enforcement of these rules and on international co-operation.

Another Member added that it was difficult to identify that a certain CG practice has failed. Financial expertise in the board of a bank was very important and could have a big impact on performance. Apparently, the banks that had a person with banking experience and knowledge as a chairman of the board performed better. This Member suggested that the independence should be understood differently in the banks, e.g. former employees of a bank should be eligible. Another Member said that the board should have collective expertise. People in the board should have diverse competences. This Member also said that the focus should be placed on the management of risks. One Member stated that, from personal experience, most of the banks analysed the risks and the management board had to submit the report on the structure of risks to the supervisory board. The problem rather lay with the supervisory board having too much faith in the risk assessments thus provided. Therefore, the problem was not the lack of analysis, but the lack of proper analysis of the risks. Another Member agreed and added that supervisory boards of underperforming banks often had failed to look at economic performance level as against regulatory compliance levels. This Member suggested that the analysis should focus on big issues (such as core structure analysis and economic leverage) instead of day to day issues. A Member reacted that looking just at developments at the board level is too narrow. One should look at the whole organisation structure of a company, all the processes in the company, not only at the end of the process.

c) Other company law and corporate governance issues

The Commission asked the Members' views on any other company law and corporate governance issues that should be considered in response to the financial crisis.

A Member was concerned that now taking risks would be seen as something negative, which would not be good for business, which naturally involved taking risks.

Another Member said that there was a need for more rules on supervisory boards. A 'fit and proper' test, currently applied in financial sector, could be better defined and used more generally. Two other Members disagreed. One said that if it was required as a prerequisite, the access to the board would be too limited. Instead, the collective expertise should be taken into account. The other Member was concerned about a more robust fit and proper test at regulatory level.

A Member said that there should be more diversity in the boards (age, nationality, gender). Another Member stated that access to the boards should be more open. Certain criteria could be considered, e.g. the number of board mandates; the maximum appointment period (e.g. a maximum of 10-20 years, unless someone had a minimum of 20% of shares). This Member also suggested having pools of people from which the board members could be chosen. It would even be an option that regulators could decide on their appointment. A Member added that companies should be required to report on their appointment processes for the boards.

On the possible increase of liability of and expertise required from supervisory directors two Members reported that in the UK, being a non-executive director already was a full-time job, which tended to be filled from a very limited pool of candidates. This was not beneficial for companies as this created an ideal environment for rather conformist attitudes. The increased liability and expertise required could make this tendency even stronger.

As regards the question whether the board was properly using the information available within the company one Member suggested that it should be generally accepted that the supervisory board member may ask for information not only from the CEO or senior management or, if necessary, turn to an outside advisor. Another Member said that the boards of banks possessed all the relevant information or expertise. It was, however, most important to clearly define the competences/responsibilities of the board. A Member said that the problem lay not with a low level of information available to the supervisory directors, but rather with the lack of identifying the issues which were important for the company. This resulted in the supervisory board acting as a 'rubber stamping' forum.

On shareholders responsibility/involvement the Members' views varied. Some said that the institutional shareholders should be held more responsible. Others said they should not be involved in setting of a company's strategy. A Member said that many institutional investors made investments on a long term basis and reducing their involvement in governance would not be such a good approach.

(4) The medium- and long-term actions in the field of corporate governance and company law

Following the discussion on the measures to tackle the financial crisis, the Commission asked the Members to share their ideas on the possible medium- and long-term actions in the field of corporate governance and company law from a broader perspective.

The first item to be discussed was the reform of the capital regime. It was agreed that after the last simplification of the 2nd Company Law Directive (CLD), it was no longer necessary to modify details of the Directive. The political debate whether to dare a complete overhaul of the system itself could regain some life through the adoption of the SPE regulation. It was clear to the Group that pressure to reform the capital regime was mainly coming from the accounting and auditing profession. Some Members disagreed on the necessity of a complete overhaul. A Member said more discussion was needed on the role of capital and the ways of protecting creditors before any new rules were put in place.

Subsequently, the Group turned to the insolvency rules. Members agreed that harmonisation of insolvency rules at EU level would be very difficult to achieve. Some of them said that lack of harmonised solvency rules seems to be a problem only in the financial sector. Shortcomings in the financial sector were already being tackled by the EU and Member States. Members concurred with the assumption that from a long-term perspective, the rules did not require a fundamental reform.

The Commission then drew Members' attention to the fact that stakeholders were increasingly lobbying for the inclusion of the concept of corporate social responsibility (CSR) in policy measures. As an example, the Commission highlighted the push to make the disclosure of environmental, social and governance data mandatory for listed companies. In addition, there was strong lobbying to extend the liability of parent

companies for human rights violations or environmental irregularities of their subsidiaries. There would be a Commission study under the lead of DG ENTR to examine the existing EU framework applicable to EU companies operating in third countries. The terms of reference were currently being finalised. One Member pointed out that the discussion on CSR was very similar to the one on corporate governance in its early stages. In some Member States, it was by now developing rapidly into a serious issue. In FR, e.g., reporting on CSR had already been made obligatory. The Group recognised the benefits of responsible corporate behaviour. A huge majority of Members, however, argued against making CSR mandatory on a European level. A Member suggested that if any legislation would be considered on this issue, it should be a recommendation.

The Members then briefly discussed the need to work on the rules governing the conflict of laws in the area of company law, a proposal that had been put forward by the German government. Whilst recognising the need for courts and company lawyers to clearly identify the applicable law when dealing with companies incorporated in another jurisdiction, Members felt that these problems were rather specific to some countries (in particular Germany and UK). Otherwise they do not occur very often in practice and, therefore, there seemed to be no need for EU rules on this issue.

The 14th CLD was seen by some Members as still being relevant. Solving the legal issues surrounding a transfer of seat should not be left to the courts. A Member stressed the necessity to get more evidence and data for the impact assessment. The Commission pointed out that a proposal was not to be expected in the immediate future, but that the European Parliament continues to press for an initiative through an own-initiative resolution prepared by the EPP-ED spokesman for legal affairs, Klaus-Heiner Lehne.

Members also discussed the question whether the existing CLDs needed further modernisation. One Member asked for an initiative to increase the transparency of ownership. The Commission pointed out that the European Parliament had asked it through own-initiative resolutions to work on three aspects: The transparency of investment policies, the transparency of voting policies and the identification of shareholders. The Commission emphasised that it was looking into these issues.

The next item for discussion was the creation of a European legal framework on groups of companies allowing the adoption at subsidiary level of a co-ordinated group policy. This proposal had been part of the medium term actions of the Commission Action Plan of 2003. The Commission, however, reported from the negative feedback by Member States on the feasibility of such project. Members concurred that in light of this, it would be unrealistic to revive the efforts on the failed 9th CLD.

The last possible measure the Group discussed was the choice of the board structure. This idea had been part of the 2006 Commission consultation on the future priorities for the modernisation of company law. Members had different views on this issue. Some of them felt that offering a choice on the European level would merely be of theoretical interest. Furthermore, courts might have difficulties dealing with the practical implications. Other Members pointed out that through the implementation of the European Company (SE), Member States had already put in place the necessary domestic legal instruments in order to allow for such a choice. It would therefore not be difficult to extend this option to purely domestic legal forms as well.

(5) Information points by the Commission services on other issues

The Commission informed the Group about the state of play of the on-going projects. The Czech presidency had made some technical progress on the European Private Company. It had just made available a revised text of the proposal. The next Council working group meeting, scheduled for 6 May, was going to discuss the paper. Discussions within Council on the more contentious issues (minimum capital, cross-border element, codetermination) were still open. Sweden had already promised to make a political effort during its upcoming term of presidency.

The simplification proposals had encountered different levels of success. The agreement between the European Parliament and Council had led to a solution close to the Commission proposal on mergers and divisions (3rd and 6th CLDs). Compromises concerned basically the obligation to provide paper copies of relevant documents at the registered office. In addition, most Member State options were deleted. The adopted Directive was expected to be published after a few months time. On publication obligations and branches (1st and 11th CLDs), however, there was still a blocking minority in Council led by France. So far, the Czech Presidency had not managed to make any progress on this file. As to the proposal to exclude micro entities from the 4th/7th CLD, further efforts had to be undertaken as there had only been one working group meeting and less than enthusiastic support from Member States.

After that the Commission outlined the status quo of various studies. The first one concerned the Transparency Directive. Here, the contractor Mazars had to deliver the final report by the end of October 2009. The content of the study should cover the perception of stakeholders of the legal framework introduced by the Directive. In addition, the study should examine the national legal framework in 14 Member States representing at least 80% of market capitalisation. It should also examine the practical implementation by issuers/investors with regard to a number of selected issues, as e.g. the home Member State rule, quarterly reporting, notification of major holdings in relation to financial instruments and dissemination of information. On the basis of the study, of further work on the cost of compliance with selected financial services directives, of analyses of cases of gold-plating and of work done by CESR, the Commission would prepare by June 2010 a report to Council and Parliament on the functioning of the Directive.

Another study was carried out by Ernst & Young. The draft interim report was expected at the end of April. It should cover the mapping of the relevant legislation applicable in representative countries on the European Company (SE), an inventory of existing SEs and the preliminary analysis of the data gathered. The final study, which should assess the effectiveness of the SE Statute, should be available by the end of the year, possibly mid-November. This would be followed up by a stakeholder conference early 2010. In the meantime, on 30 June 2009, BusinessEurope would hold a roundtable discussion on the SE. It could already be made note that at present, there were about 300 SEs in Europe.

The Commission also reported that the study on the feasibility of a European Foundation Statute carried out by the Max Planck Institute Hamburg and the University of Heidelberg had been finalised in December 2008 and published on DG MARKT's website on 16 February 2009. On the same date, a public consultation had been launched to probe the practical need for such a statute from a broader audience. The deadline for

replies was 15 May 2009. The Group was informed that so far, there had only been less than ten replies.

As to the mapping of the corporate governance codes, the study to be done by RiskMetrics along with its subcontractors Landwell Associates, BusinessEurope and EcoDa was well under way. The draft final report was expected for the end of July, the final report for the end of September. It was noted with attention that the contractors had difficulties in obtaining replies from investors as to the quality of companies' disclosures on the application of corporate governance principles and of explanations given where the company declares not to comply. It was assumed that the low level of feedback, despite repeated extensions of deadlines, had to do with a lack of interest from investors for these questions. In this context, the Commission informed the Group about a planned conference on company law and corporate governance under the Swedish Presidency. One of the panels would deal with the study which would be presented for the first time by RiskMetrics. The date had not been confirmed yet, but it was expected to be on 2 and 3 December 2009. Finally, the Members were informed about the next conference of the Transatlantic Corporate Governance Dialogue in Washington on 17 September 2009.

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