

Statement of the European Corporate Governance Forum on the comply-or-explain principle

1- The “comply or explain” principle has become a feature of Europe’s approach to corporate governance. National Corporate governance codes lay down rules or recommendations which are not of mandatory application, but companies must either comply with them or explain publicly why they are not complying with some of their provisions.

The Forum strongly and unanimously supports this approach, which is best suited to take into account the variety of situations of individual companies, and fits well with the differences between national legal and governance frameworks. The Forum believes that, when it is effectively implemented, this is a better and more efficient approach than detailed regulation.

The experience of countries which have implemented this approach for several years shows that it does lead to a movement of convergence towards better governance practices.

2- For this approach to be effective, however, there has to be:

- a real obligation to comply or explain. Depending on the countries, this obligation can result from corporate law, from the regulatory authority, or from listing standards
- a high level of transparency, with coherent and focused disclosures
- a way for shareholders to hold company boards (unitary or dual) ultimately accountable for their decisions to comply-or-explain and the quality of their disclosures.

The comply-or-explain approach depends therefore on the appropriate regulatory framework, and on the existence and practice of sufficient shareholders rights.

3- Different approaches to the role of regulators and auditors have been proposed, or implemented in different countries. The Forum believes lessons should be drawn from these approaches before any general conclusion can be drawn.

However, the Forum believes the corporate governance statement which explains the areas of compliance as well as the reasons for non-compliance, is the responsibility of the company’s board(s), for review and discussion with the shareholders.

It therefore inclines to the view that regulatory authorities should limit their role to checking the existence of the statement, and to reacting to blatant misrepresentation of facts. They should not try and second-guess the judgement of the board(s) or the value of its/their explanations. This is a matter for the company's shareholders.

Similarly, the auditors should not be supposed to evaluate the judgement of the board(s), but may within their duties be called upon to review some element of facts contained in the statement.

4- Evaluation by shareholders of the corporate governance statement should be an element of their voting decision at the shareholders meetings. The Forum recommends that the services, which advise shareholders on these votes, consider the corporate governance statement of each company on its merits, and not only by "box-ticking". Ultimately it is shareholders, not these services, which are responsible for voting decisions. But this also requires of companies to give meaningful explanations for deviations of code provisions.

5- Particular attention should be given to the case of companies controlled by one or a few large shareholders. In that case, it is advisable that in particular independent directors should have a specific and identifiable role in the approval of the corporate governance statement.

6- The Forum urges Member States to set up processes that allow for the monitoring of the application of corporate governance codes. Such monitoring processes will increase our understanding of the effectiveness of corporate governance codes, and highlight what issues appear to be complicated, where developments are satisfactory and where they are not.

7- Where a company is incorporated in one Member State but its shares are listed in one or more other Member States, the result may be that either more than one corporate governance code applies to that company or no code at all. The Forum takes the view that in such cases at least one code should be applied by the company, but double application is to be avoided. The Forum will further work with the Commission on ways how to implement this principle.

8- The Forum urges Member States who have not yet adopted a code to do so. It intends to continue monitoring the implementation of the comply-or-explain approach in the countries of the European Union. The Forum will set up links with national organisations within the Member States charged with the responsibility for corporate governance codes and the monitoring of their application. It will report from time to time about progress made or outstanding issues.