



## EUROPEAN COMMISSION

Internal Market and Services DG

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

Brussels, 18 January 2008

### **EUROPEAN CORPORATE GOVERNANCE FORUM**

#### **Minutes of the meeting of 22 November 2007**

##### **1. APPROVAL OF THE AGENDA**

The agenda was approved without discussion.

With a view to the fact that the Forum's current mandate expired on 17 October 2007, the chairman stressed the importance, for the Commission, of having access to a group of corporate governance experts from different backgrounds. DG MARKET therefore would be interested in continuing with the Forum's work. The question would be discussed with the Commissioner the same week, the Forum remaining in office, according to the applicable Commission decision of 2004, until a decision on its renewal has been taken.

##### **2. PROPORTIONALITY BETWEEN CAPITAL AND CONTROL**

The chairman referred to Commissioner McCreevy's decision of 3 October 2007 not to pursue any further action in this field. He stressed that the Forum's contribution would probably have been the most influential outside force in the work on this file. Although he agreed with the Forum's view that there should be no major difference between the Forum's views and that of the Commission this would not mean that opinions would always have to be identical.

One member expressed the view that the result would be very unfortunate. The Commission would in general not have any plans for initiatives aiming and ensuring that shareholders can exercise their rights in order to improve corporate governance. Therefore it would probably be for the Forum to set up an agenda in this field.

Another member indicated having been surprised by the decision in the same way that he had been surprised by the Commissioner's original announcement to undertake action in that field. The Commission should consider taking up at least the part of the statement that recommends collecting further information. This would be a very modest approach; there would be no point in closing the door forever.

A third member stressed that restricting the discussion to transparency issues had been the Forum's achievement. Evidence would in the end not have been strong enough even for recommendations on transparency. However, the Commissioner would not be the only one having come to this conclusion; also the OECD came to the same result in mid-November.

Other members took the view that the process had worked very well. However, dropping the question altogether would clearly be a mistake given that the market pushes into the direction of one share – one vote. From now on, focus should lie on fighting abuses. One of them reminded of the starting point where all members, at the Commissioner's announcement end of 2005, had agreed that it would be premature for the Commission to recommend the application of the one share – one vote principle. Although the ideal case would have been if the ball had not been dropped completely, one should not forget that the Forum's emphasis had always been on the need to take account of the national differences and to leave things to the national level to the extent possible. Another member stressed that the issue will come back at the moment of the discussion on the revision of the Takeover bids Directive at the latest. However, for the time being the Forum should concentrate on questions like the protection of minority shareholders, acting in concert etc..

One member referred to the Transatlantic Corporate Governance Dialogue (TCGD) that had been organised i.a. by the ECGI on 9 October. From the discussion it would have become clear that the US, in corporate governance, focuses strongly on the enforcement side and judges foreign systems according to the means by which rules can be enforced. Dropping the issue of proportionality would render it more difficult to convince the US of the effectiveness of the EU system and to agree on mutual recognition.

The Commission stressed that the Commissioner's decision had been a political one that had been based on a two years' discussion. In order to make progress in corporate governance, it would be important to concentrate on the Forum's original mandate, i.e. to monitor the convergence of national codes. DG MARKT currently is trying to make a budget available for an outside study that should provide an overview of the existing codes and their practical application by the companies. The ECGI has already done valuable work in that area but a comprehensive picture is still lacking. Once the information will be available, issues such as conflicts of interest and acting in concert could then be addressed specifically in order to make sure that the European system functions.

One of the members supported the proposal to commission a study on the situation in the Member States. As the current developments in some MS would show, there is a risk of a fragmentation of the financial markets. Another member explained that the TCGD had shown that the European system provides the EU with a considerable competitive advantage compared to the US. This would give reason to hope that the markets will also deal with the one share – one vote problem. National differences should be maintained but there would also be a need to deal with abuses that are indeed often linked to protectionism.

Members agreed to fix an agenda for its future work, on the basis of the discussion, and set up a small working group to submit a draft work programme before the next Forum meeting. One member took the view that in the context of the protection of minority shareholders the different perceptions of what minority shareholders are would need to be taken into account. Also the issues of sovereign wealth funds and hedge funds should be taken on the agenda.

The Commission asked to be involved into the preparation of the work programme, also in order to enable it to ensure that the terms of reference of the possible study will fit with the agenda.

Addressing another point of the Commissioner's speech, one member expressed disappointment with the decision not to propose a directive on the transfer of the registered office. To set up a company in another Member State in order to move the seat by cross-border merger would be a very expensive solution. The ECJ would sooner or later take a decision allowing for the transfer on the basis of the treaty provisions. Then considerable difficulties could be expected as guidance on technicalities will be missing.

### **3. DISCLOSURE OF DERIVATIVE POSITIONS**

One member gave an overview of the new regime of derivative disclosure put in place in the UK in 2005. The City Code on Mergers and Takeovers requires disclosure of dealings in options and other derivatives during a takeover offer period by a person that is interested in 1% or more of the securities of an offeror or the offeree or that, as a result of any transaction, will be interested in 1% or more.

He explained that the new rules increased the number of disclosures significantly and the market finds the new disclosures useful. The question has arisen in the UK whether this regime should be extended to disclosures outside the bid period, but the enforcement of this extended regime could be difficult and it would require considerable resources. Similarly, it is currently being considered whether disclosure on stock lending would be useful, however, the main difficulty in this respect seems to be that stock lending often does not aim to affect voting. Therefore such disclosures could prove to be confusing.

He indicated that the FSA had published a consultation paper on possible proposals to increase disclosure on contracts for difference (CFD). The idea is to make stake-building more transparent. CFDs do not carry voting rights, but can be converted into shares with voting rights by the investment banks who sell the derivatives and hold the underlying shares in order to hedge their own positions. Furthermore, he mentioned that leading hedge fund managers advocated improved disclosure on derivatives, including CFDs recently.

#### *Advantages of derivative disclosure*

Members agreed that derivative disclosure is useful, i.e. it allows investors to track transactions which may result in voting positions and stake building. Derivatives allow the derivative buyer to swing votes even if they do not provide voting rights directly, as the counterparty bank usually hedges its derivative position by holding the underlying securities, which are warehoused and will not be voted. Furthermore, it is easy to convert e.g. a contract for difference into shares with voting rights. One member emphasised that it is irrelevant whether voting rights are acquired directly or indirectly, both should be disclosed. Derivative disclosure does not entail huge compliance cost. This member stressed that the market abuse aspect should be taken into account in the sense that an investor would be in breach of his obligations where he votes on the basis of an economic interest that is contrary to the company's interest. The supervisory authorities would dispose of the necessary information to be able to punish such market abuse. A question would be whether the possibility should be created for third parties to ask for investigations by the supervisory authority.

#### *Empty voting*

The question has arisen whether it would be appropriate to establish a rule whereby a person would be prevented from voting if he does not have an economic interest in a

share. Some members argued that it would be impossible to establish such a rule, but appropriate disclosure on the voting right should be required at least where a person does not have the economic interest.

It has been debated whether disclosure of the economic interest would not be adequate to address the issue of empty voting. One member suggested that a possible route would be to require disclosure when a large stake in a company is hedged.

#### *Stock lending*

Some members emphasised the difficulties a general disclosure regime on stock lending positions would entail, as stock is often borrowed to be sold, rather than to be voted. The information could therefore confuse the market, rather than providing additional transparency. Furthermore, the impression would be that stock lending would not in all cases be properly reported. In these cases, disclosure would not be possible. Nonetheless, stock lending has been used to swing votes at general meetings therefore members agreed that this issue should be examined carefully.

The Commission inquired whether a recommendation regarding the separation of the date for the entitlement to the payment of dividends and the record date would be useful to shed more light on the motivations of stock lending. One member supported the idea, stressing that a similar recommendation had been adopted in FR. Another member pointed out that stock exchanges may need to be involved at least in some markets, as the practices of dividend dates are sometimes related to stock exchange practices. Participants agreed that in view of the importance of this matter, they would discuss this issue further and possibly establish a working group to come up with suggestions.

#### **4. CONTACTS WITH NATIONAL BODIES – MONITORING OF THE COMPLY OR EXPLAIN PRINCIPLE**

The Commission referred to the possible future study on the codes in the Member States and their application. This study should fill the existing information gap. In addition, a conference could be organised in 2009 in order to discuss its results and to reflect about future work at EU level.

One member stressed that the study should also look at enforcement. There would be a need to make the case that enforcement against illegal practices is taken seriously in the EU. The Forum would need to have a clear picture and a position on the issue. Another member, however, recalled that enforcement mechanisms in the Member States follow very different roads (corporate crime, company law and security regulators). If all these were to be taken into account the study would become very complex. Other members took the view that information on enforcement regarding misleading financial information, market abuse and accounting could be provided. On the general compliance with codes there would be a need to look at longer periods in order to establish the tendency in the market. It was also stressed that several studies on fraud show difficulties to prosecute these crimes. IE had reacted to this by setting up the Office of the Director of Corporate Enforcement which would have proven to be very efficient. The idea of hard law enforcement would seem very attractive in areas where private enforcement mechanisms fail; also interventions at the TCGD had shown this. However, one would have to be very careful in this area.

Another member pointed out to two issues in relation with the possible study: the codes in the MS are not equally strict; therefore, compliance has a very different meaning in the different cases. A simple comparison of the degrees of implementation could, consequently, be very misleading. Finally, the degree of compliance as such would not be a meaningful indicator. The possibility to explain deviations from the codes is the strength of the system and should not be judged negatively. Another member added that an element of change would also need to be taken into account. After each change of the combined code, compliance rates go down until companies have got used to the new rules. One member proposed that a study could also look at more general questions of enforcement: a particularly deterrent system would not necessarily further a high degree of compliance as it could also lead to people getting reluctant to adhere to the system.

The chairman proposed to come back on the issue at the next meeting. In any case, more information on this issue is needed.

## **5. SOVEREIGN WEALTH FUNDS**

Commissioner Mc Creevy joined the meeting for the discussion on sovereign wealth funds. He first thanked Forum members for their contribution to the debate on one-share-one-vote, which was very much appreciated. The Forum's position will be reflected in the Impact Assessment to be published shortly. One member reiterated that the Commissioner's decision not to go ahead with one-share-one-vote should not direct the Commission's focus away from minority shareholder protection. A lot remains to be done. The Commissioner encouraged the Forum to continue their work on minority shareholder protection.

Commissioner Mc Creevy introduced the debate on sovereign wealth funds (SWF) by emphasising that sovereign wealth funds have been there for many years without having been a threat for Europe. Although such funds are becoming bigger players now, the EU needs to tread carefully in this debate. Foreign investment is good for the EU economy, it generates growth and jobs. The EU should not scare investors away from its shores. Rules are in place on national security protection and it needs to be seen whether the current legal environment is not sufficient to tackle problems raised by sovereign wealth funds.

Some members emphasised the need for taking appropriate measures at EU level. One member was of the opinion that some Member States use sovereign wealth funds as an excuse to become more protectionist. In the absence of EU action in this area, Member States will intervene and possibly abuse of their leeway, which may result in closing-off parts of the market. The importance of open markets as a prerequisite of cheap capital was emphasised.

One member argued that the issue of sovereign wealth funds should be put in the wider context of reciprocity, and the EU should have more flexible mechanisms to deal with threats raised by such funds: current EU rules do not give appropriate discretionary power to block certain investments, which would be necessary in this context. Another member proposed to give more power to companies' boards to prevent a state to use investments for political purposes contrary to the interests of the company, e.g. by suspending the voting right. This mechanism would provide for a flexible solution in particular in cases where an originally financial investment has turned into a political investment, e.g. after a change in government.

Some other members do not see any added value of introducing new EU rules in this area. One member argued that if certain states with huge reserves would want to use their funds to weaken the EU, they could do it more efficiently e.g. through intervening on the foreign exchange market. Taking over companies at least would lead to getting them involved and to bear risks. A number of members considered that in any case any intervention would have to be restricted to certain sectors, like e.g. energy, defence or communication. One member recalled, however, that one should take account of the fact that the EU should, along with national governments have considerable powers already over regulated industries, such as gas and electricity utilities or the financial sector. Such powers should probably enable most of the difficulty surrounding the sovereign wealth risks to be addressed. One of these members suggested rather to encourage SWFs to adopt voluntary codes of conduct, similar to those envisaged by the hedge fund industry.

The Commissioner closed the debate by stressing that any decision in this area would require time and thorough analysis.

## **6. UPDATES ON ONGOING COMMISSION INITIATIVES**

### **6.1. Simplification of the Company law *acquis***

The consultation on the Commission communication of 10 July has been closed. The summary report is about to be finalised and should be published on DG MARKT's website before Christmas.

The reactions show that simplification in EU company law is generally welcomed, even if a majority of respondents is not in favour of repealing entire directives as this was proposed as one possible option in the communication. Also with a view to the field of accounting and auditing respondents were supportive to most of the proposals made in the communication.

### **6.2. Commission recommendation on the exercise of shareholders' rights**

The works on the impact assessment have almost been finalised. Whereas there seems to be some scope for light-touch measures in the area of the role of intermediaries and with a view to stock lending, issues like depositary receipts are not likely to be touched upon in any future recommendation. If the decision is taken to propose a recommendation on the issue to the Commission, this will not be before February 2008.

### **6.3. Impact assessment for the Statute of a European Private Company**

The work on the impact assessment has started. In order to test the ideas with the public, DG MARKT will organise, in March 2008, a conference in Brussels on the subject.

## **7. CONCLUSION**

The 2008 meeting dates will be determined after the discussion with the Commissioner on the renewal of the Forum's mandate has taken place.