

European Commission: DG Internal Market and Services
Conference on European Company Law: The way forward
Charlemagne building, Brussels
16 and 17 May 2011

Panel discussion:
"Groups of companies and the current European Company Law framework"

Transparency of group structures and relations

Leena Linnainmaa
Deputy Director General
Finland Chamber of Commerce

An appropriate level of transparency is a key issue for promoting good corporate governance of companies, especially listed companies. The issue is quite complicated due to many factors. First of all, listed companies are an extremely heterogeneous group. A listed company's market value may be only a few million Euros, some companies are multinational groups with listings in several markets whereas many companies are somewhere between these extreme examples. Consequently, the resources of listed companies differ to a great extent. Nevertheless, most rules and regulations are the same regardless of the size or resources of the listed company.

All Europe is suffering from a serious problem; during the recent years there have been hardly any new stock exchange listings. IPO's are almost non-existent. If Europe wishes to be successful, we definitely need this problem to be solved. A major part of the problem is the very burdensome regulatory framework concerning listed companies' transparency, corporate governance, accounting etc. So we have to be extremely careful before proposing any new legislation or rules adding the companies' administrative burden.

Any solution has to be made after careful consideration, taking into account investors' need for information and the reasonable level for companies' administrative burden and costs.

The issue of transparency of group structures is especially difficult. Groups of companies are very heterogeneous. In some cases a listed company is a holding company and its subsidiaries are the ones conducting all business whereas there are groups with subsidiaries acting as sales offices only in different countries. Large groups may have hundreds of subsidiaries all over the world.

The question is if basic information on a listed company's group structure can be assessed to be easily accessible through the current regime of financial statements and annual reports. Although there are numerous and detailed rules on group information, there is no rule requiring an annual report, corporate governance statement or company website to describe the main features of a company's group structure in a clear and investor-friendly manner. Currently, for example, some

companies' annual report contains a chapter on changes in group structure without providing information on the existing group structure.

Transparency has been significantly improved since 2002 for listed companies due to the adoption of the Transparency Directive (2004) and the Takeover Directive (2004). Likewise, transparency has been improved for companies establishing consolidated accounts due to the modification of the 7th accounting Directive on consolidated accounts (2003, 2006) and to the adoption of many IFRS standards (e.g. IAS 24 on Related party transactions). Of special interest is the corporate governance statement.

The objective of a corporate governance statement is to provide shareholders with easily accessible key information about the corporate governance practices actually applied, including a description of the main features of any existing risk management systems and internal controls in relation to the financial reporting process as well as information concerning the group's risk management system and internal control system.

The point of view of corporate governance statements differs from the objective of rules concerning financial statements and annual reports. The objective of corporate governance statements is to provide key information in an investor-friendly manner whereas rules on financial reporting emphasize accurateness and aim for giving a full picture of the financial status of the group. The level of expertise needed to study corporate governance statements for receiving information is nowhere near the expertise required for studying financial statements. For this reason, corporate governance codes require information to be given in an investor-friendly manner.

Assessment of regulatory needs

Considering the current rules on transparency of groups of companies, there are no considerable regulatory needs. The existing European and national rules seem already to provide an adequate disclosure and information on the formation, organisational structure and management of groups of companies. Of course, this legal regime may always be improved and some new rules for a certain specific problem could be thought of (e.g., interlocking directorships). But these would correspond to mere sporadic rules, thus insufficient to give rise to an autonomous or substantial issue on group transparency.

One point of view, however, is the actual amount of information available under the current regime and another is the clarity and investor-friendliness of the current information given by listed companies.

i) *Transparency of the formation of groups*

In general, there can be seen a need for enhanced transparency concerning the formation of groups of non-listed companies or the formation of groups via other types of mechanisms (e.g., articles of association, personal linkages, etc.). Regulating unlisted companies in this field is not advised. Whereas this extension would promote an equal level playing field for both listed and non-listed groups, it would cause unnecessary administrative burden to unlisted companies, SME's in particular.

Regarding the *other mechanisms of group formation*, there seems to be no case for a further regulatory intervention. The Takeover Directive 2004/25/EC provides some duties of giving information in respect of cross shareholdings, special control rights and certain shareholder agreements. According to article 10 of the Takeover Directive, the company shall publish information

in its annual report about inter alia significant direct and indirect shareholdings (including indirect shareholdings through pyramid structures and cross-shareholdings), the holders of any securities with special control rights and a description of those rights as well as any agreements between shareholders which are known to the company and may result in restrictions on the transfer of securities and/or voting rights.

ii) *Transparency of group structure*

It seems that the existing European and national accounting rules already provide an adequate *disclosure of the structure of group*, that is, a transparent image of the network of inter-corporate relationships between the parent and its subsidiary companies.

Furthermore, the transparency of group structure is also enhanced, in relation to groups of listed companies, by other disclosure rules provided for in some national laws or in corporate governance codes.

An issue to be discussed could be the case of interlocking board of directors. A disclosure of such “multiple director” practice and interlocks seems already ensured for the case of listed companies, at least partially. Most Corporate Governance Codes expressly contain several requirements which may also be relevant in this regard (e.g., requirement of “independence” for members, requirement of approval of multiple directorship by the supervisory board).

The question remains, however, if basic information on a listed company’s group structure can be assessed to be easily accessible through the current regime of financial statements and annual reports. For example, in some cases the listed company is a holding company and subsidiaries are the ones conducting all business whereas there are groups with subsidiaries acting as sale offices only in different countries. This basic information should cover e.g. main features on how the group conducts its business, including information on intra-group relationships. Although there are numerous and detailed rules on group information, there is no rule requiring an annual report, corporate governance statement or company website to describe the main features of a company’s group structure in a clear and investor-friendly manner. It should also be assessed if a list of subsidiaries should be available for stakeholders.

Although there are numerous and detailed rules on group information, there is no rule requiring an annual report, corporate governance statement or company website to describe the main features of a company’s group structure in a clear and investor-friendly manner. Currently, for example, some companies’ annual report contains a chapter on changes in group structure without providing information on the existing group structure.

Although studies on corporate governance statements have been conducted in some Member States, there is no overall assessment of the functioning of the Directive 2006/46. Before any decision on the necessity or usefulness of a review of the Directive is made, the functioning of the current regime should be assessed. Listed companies should not be burdened with new requirements if there is no proof of a need to amend the Directive. When the functioning of the rules on corporate governance statements is examined, one aspect should be to study the need and usefulness of adding a requirement to give basic information on the group structure in the corporate governance statement. At the same time, it should be assessed if there is a need for giving basic information on the group functioning and management in corporate governance statements. However, it is very important to avoid causing any unnecessary administrative burden to companies.

If it is established that investors benefit from easily accessible information on group structure given in corporate governance statements, and that the benefits outweigh the cost to companies of providing such information, the Commission should act through an amendment to the 1978 Accounting Directive as amended by Directive 2006/46. The Directive is currently under review by the Commission, so this aspect should be added to the review. The obligations created should in any case be limited to listed companies.