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**COMMISSION RECOMMENDATION**

**of **XXX****

**on the quality of corporate governance reporting ('comply or explain')**

(Text with EEA relevance)

{SWD(2014) 126}

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## COMMISSION RECOMMENDATION

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**on the quality of corporate governance reporting ('comply or explain')**

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 292 thereof,

Whereas:

- (1) An effective corporate governance framework is of key importance to society, as well-run companies are likely to be more competitive and more sustainable in the long term. Good corporate governance is first and foremost the responsibility of the company concerned, and rules at European and national level are in place to ensure that certain standards are respected. These include legislation and soft law, namely national corporate governance codes.
- (2) Corporate governance codes aim to establish principles for good corporate governance in listed companies in Europe based on transparency, accountability and a long-term perspective. They provide standards and best practice for companies, enabling them to perform better and therefore contribute to fostering growth, stability and long-term investment.
- (3) Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings<sup>1</sup> requires companies to include a corporate governance statement in their management report if their transferable securities are admitted to trading on a regulated market of any Member State within the meaning of Article 4(1)(14) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments<sup>2</sup>.
- (4) The corporate governance statement should provide essential information on the corporate governance arrangements of the company, such as information relating to the relevant corporate governance code(s) applied by that company, the internal control and risk management systems, the shareholder meeting and its powers, shareholders' rights, administrative, management and supervisory bodies and their committees.
- (5) High quality disclosure on companies' corporate governance arrangements offers useful information to investors and facilitates their investment decisions. It also gives investors more confidence in the companies they invest in. Increased transparency to

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<sup>1</sup> OJ L 182, 29.6.2013, p.19.

<sup>2</sup> OJ L 145, 30.4.2004, p.1.

the market can also bring, more generally, reputational benefits for companies and more legitimacy in the eyes of stakeholders and society as a whole.

- (6) The ‘comply or explain’ principle laid down in Article 20 of Directive 2013/34/EU is a key feature of European corporate governance. According to this principle, companies that depart from the relevant corporate governance code are required to explain in their corporate governance statement which parts of the code they depart from and the reasons for doing so.
- (7) While full compliance with a code can send a positive message to the market, it may not always be the best approach for a company from a corporate governance perspective. Departing from a provision in the code could in some cases allow a company to govern itself more effectively. The ‘comply or explain’ approach provides companies with flexibility by allowing them to adapt their corporate governance to their size, shareholding structure or sectoral specificities. At the same time, it promotes a culture of accountability, encouraging companies to reflect more on corporate governance arrangements.
- (8) The ‘comply or explain’ principle is widely supported by companies, investors and regulators as an appropriate tool in corporate governance. Yet, as mentioned in the 2011 Green Paper on the EU corporate governance framework<sup>3</sup>, it appears that there are some shortcomings in the way the principle is applied in practice, in particular as regards the quality of explanations provided by companies when departing from corporate governance codes. In this respect, a large majority of respondents to the Green Paper were in favour of requiring companies to provide better quality explanations in case of departures.
- (9) According to more recent evidence gathered by the Commission, there has been gradual improvement in this area. Several Member States have, for instance, initiated discussions or issued guidelines on the quality of explanations. However, there is still scope for further improvement.
- (10) In its resolution of 29 March 2012<sup>4</sup>, the European Parliament considered the ‘comply or explain’ approach a useful tool for corporate governance. In particular, it was in favour of compulsory adherence to a relevant code by the company and requiring meaningful explanations for departures from a code, which should include a description of the alternative measure taken.
- (11) The 2012 Action Plan on European company law and corporate governance<sup>5</sup> underlined the importance of high quality explanations, in particular for investors, and announced a Commission initiative to improve the quality of corporate governance reports and the quality of explanations in particular.
- (12) The purpose of this Recommendation is to provide guidance for companies and to assist them in improving the quality of their corporate governance reporting. Given the diversity of legal traditions and approaches, these recommendations offer a general framework, which can be further developed and adapted to the specific national context.
- (13) This Recommendation applies to companies which are required to submit a corporate governance statement in accordance with Article 20 of Directive 2013/34/EU and

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<sup>3</sup> COM(2011) 164; 5.4.2011.

<sup>4</sup> European Parliament resolution of 29 March 2012 on a corporate governance framework for European companies, 2011/2181(INI).

<sup>5</sup> COM(2012) 740, 12.12.2012.

which need to provide explanations in case of departure from the recommendations of the corporate governance code(s).

- (14) While this Recommendation is intended predominantly for listed companies pursuant to Article 20 of Directive 2013/34/EU, other entities preparing a corporate governance statement might also benefit from enhancing the quality of information they plan to disclose.
- (15) In addition to the information that they are required to provide in their corporate governance statement, companies in some Member States are also required to report on how they apply the main principles or recommendations of the code. In order to further improve transparency, all European listed companies are encouraged to report on how they followed the relevant codes regarding aspects which may be most important for shareholders. In addition, in order to facilitate access, companies should consider making this information also available online.
- (16) There is no standard format for corporate governance reporting throughout the Union. Presenting information in a general statement or on a provision by provision basis is acceptable as long as it is informative and useful for shareholders, investors and other stakeholders. Companies should avoid making overly general statements, which might not cover important aspects to shareholders but also, box-ticking statements with little informative value. Likewise, they should also avoid providing lengthy information which might not give sufficient insight.
- (17) Appropriate disclosure of departures from the relevant codes and of the reasons for such departures is very important to ensure that stakeholders can make informed decisions about companies. Such disclosure reduces the information asymmetry between the company directors and its shareholders, and therefore, decreases the monitoring costs for the latter. Companies should clearly indicate which recommendations of the code they have departed from and, for each instance provide an explanation regarding: the manner in which the company has departed, the reasons for the departure, the way in which the decision to depart from a recommendation has been arrived at, the timeframe of the departure and the measures taken to ensure that the company action remains consistent with the objectives of the recommendation, and of the code.
- (18) In providing this information, companies should avoid using standardised language and should focus on the specific company context that explains the departure from a recommendation. The explanations should be structured and presented in such a way that they can be easily understood and used. This will make it easier for shareholders to engage in a constructive dialogue with the company.
- (19) An effective ‘comply or explain’ approach requires efficient monitoring to motivate businesses to comply with a corporate governance code or to explain non-compliance. The 2011 Green Paper indicated that the corporate governance statements which companies publish seemed not to be monitored as they should be and few Member States had public or specialised bodies check the completeness of the information provided, and in particular the explanations.
- (20) Various actors, such as boards, auditors and shareholders, are involved in monitoring the information disclosed by companies. Boards and shareholders also have an important role to play in encouraging good quality explanations. In particular, more active monitoring by shareholders, as owners of companies, could lead to better corporate governance practices.

- (21) Member States and bodies responsible for corporate governance codes are also encouraged to consider how more attention could be paid to the overall quality of explanations for departures submitted by companies in the context of the existing monitoring arrangements in their countries. Additional means of incentivising companies and other parties concerned could also be considered, to further improve the quality of the explanations and of corporate governance reporting in general.
- (22) In order to ensure efficient follow-up to this Recommendation, Member States should draw it to the attention of the bodies responsible for the national corporate governance codes, listed companies and other parties concerned. Member States should also inform the Commission about measures taken in accordance with this Recommendation.

HAS ADOPTED THIS RECOMMENDATION

## SECTION I

### GENERAL PROVISIONS

1. The purpose of this Recommendation is to provide guidance to Member States, bodies responsible for national corporate governance codes, companies and other parties concerned. The guidance aims to improve the overall quality of corporate governance statements published by companies in accordance with Article 20 of Directive 2013/34/EU and, specifically, the quality of explanations provided by companies in case of departure from the recommendations of the relevant corporate governance code.
2. It is recommended that, where applicable, corporate governance codes make a clear distinction between the parts of the code which cannot be derogated from, the parts which apply on a 'comply or explain' basis and those which apply on a purely voluntary basis.

## SECTION II

### QUALITY OF CORPORATE GOVERNANCE STATEMENTS

3. Article 20(1) of Directive 2013/34/EU requires listed companies to provide information about specific aspects of their corporate governance arrangements in their corporate governance statement.
4. In order to further improve transparency for shareholders, investors and other stakeholders, and in addition to the information on the topics referred to in paragraph 3, companies should describe how they have applied the relevant corporate governance code recommendations on the topics of most importance for shareholders.
5. The information referred to in paragraphs 3 and 4 should be sufficiently clear, accurate and comprehensive to enable shareholders, investors and other stakeholders to gain a good understanding of the manner in which the company is governed. In addition, it should refer to the company's specific characteristics and situation, such as size, company structure or ownership or any other relevant features.
6. In order to provide easier access for shareholders, investors and other stakeholders, companies should routinely make the information referred to in paragraphs 3 and 4

available on their websites and include a reference to the website in their management report, even if they already provide information by other means specified in Directive 2013/34/EU.

### **SECTION III**

#### **QUALITY OF EXPLANATIONS IN CASE OF DEPARTURE FROM A CODE**

7. Article 20(1) of Directive 2013/34/EU requires listed companies to provide explanations in case of departure from the recommendations of the code to which they are subject or which they have voluntarily decided to apply.
8. For the purpose of paragraph 7, companies should clearly state which specific recommendations they have departed from and, for each departure from an individual recommendation:
  - (a) explain in what manner the company has departed from a recommendation;
  - (b) describe the reasons for the departure;
  - (c) describe how the decision to depart from the recommendation was taken within the company;
  - (d) where the departure is limited in time, explain when the company envisages complying with a particular recommendation;
  - (e) where applicable, describe the measure taken instead of compliance and explain how that measure achieves the underlying objective of the specific recommendation or of the code as a whole, or clarify how it contributes to good corporate governance of the company.
9. The information referred to in paragraph 8 should be sufficiently clear, accurate and comprehensive to enable shareholders, investors and other stakeholders to assess the consequences arising from the departure from a particular recommendation.

It should also refer to the specific characteristics and situation of the company, such as size, company structure or ownership or any other relevant features.
10. Explanations for departures should be clearly presented in the corporate governance statement in such a way that they are easy to find for shareholders, investors and other stakeholders. This could be done, for example, by following the same order of recommendations as in the relevant code or by grouping all explanations for departure in the same section of the corporate governance statement, as long as the method used is clearly explained.

### **SECTION IV**

#### **FINAL PROVISIONS**

11. In order to motivate companies to comply with the relevant corporate governance code or to better explain departures from it, efficient monitoring needs to be carried out at national level, within the framework of the existing monitoring arrangements.
12. Member States should draw this Recommendation to the attention of the bodies responsible for national corporate governance codes, listed companies and other parties concerned. Member States are invited to inform the Commission of the

measures taken in accordance with this Recommendation by [*date 12 months after the date of publication of the Recommendation*], in order to enable the Commission to monitor and assess the situation.

13. This Recommendation is addressed to the Member States, bodies responsible for national corporate governance codes, listed companies and other parties concerned.

Done at Brussels,

*For the Commission*  
*Michel Barnier*  
*Member of the Commission*