

European Corporate Governance Forum

Annual Report 2005

1. INTRODUCTION

The European Corporate Governance Forum was established by Commission Decision of 15 October 2004¹. The list of its members is contained in the Annex to this report.

The creation of the Forum is one of the key measures provided for by the Action Plan on Modernising Company Law and Enhancing Corporate Governance of May 2003². The Forum held its first meeting on 20 January 2005 and two further meetings on 20 June and 21 November respectively. At its first meeting, the Forum elected Bertrand COLLOMB as its spokesperson for a three-year-mandate.

2. ROLE OF THE EUROPEAN CORPORATE GOVERNANCE FORUM

The mission of the European Corporate Governance Forum is to provide high level policy advice in the form of strategic orientations to the Commission – including areas of priority, concerns etc – taking into account the global dimension of corporate governance issues. The Forum attaches great importance to the exchange of information on the development of corporate governance practices in the Member States as well as the identification of shortcomings on the basis of common general principles of good governance.

In this regard, the Forum's work focuses on listed companies. In order to obtain a comprehensive overview of corporate governance practices throughout the European Union, the Forum not only considers the national codes of corporate governance but also examines effective practices developed on other basis than national codes. Action to enhance convergence inside the

¹ OJ L321, p. 53;
(http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/oj/2004/l_321/l_32120041022en00530054.pdf)

² COM(2003)284 final;
(http://europa.eu.int/comm/internal_market/company/modern/index_en.htm)

EU is only recommended to the Commission where action at EU level is needed to solve specific problems that reduce the efficiency and therefore the competitiveness of companies and the efficiency of the capital markets, or that affect negatively the confidence of shareholders. Finally, in order to ensure global coherence account is also taken of the international perspective, i.e. in particular the developments in the United States and at the level of the OECD.

In addition to this analytical work the Forum also considers assuming an educational mission: it aims at raising awareness amongst the key players about the importance of corporate governance for investors' confidence and, thus, for the further integration of the European financial markets. To this end, Forum members in 2005 participated in several conferences on corporate governance, including the two Corporate Governance Conferences organised successively by the Luxembourg and British Presidencies. On these occasions, the members of the Forum gave a first overview of the issues which the Forum considers most urgent in the field of corporate governance.

3. WORKING METHODS INCLUDING TRANSPARENCY AND PRESS POLICY

The Forum meets two to three times per year. In order to ensure a high level of transparency, in advance of each meeting the date and the agenda and, after the meeting, the minutes are published on the website of DG Internal Market and Services³.

Statements to the press, on behalf of the Forum, fall within the competence of the Forum's spokesperson. Furthermore, the spokesperson disseminates information on common positions.

4. ISSUES APPROACHED IN 2005

The Forum took stock of the last years' developments in the Member States in the field of corporate governance. It then opened the discussion on three main topics that have been identified as questions of common interests:

- (1) the "comply-or-explain" principle,
- (2) the role and the rights of shareholders in the company and
- (3) the existing EU rules on internal control and risk management mechanisms.

³ http://europa.eu.int/comm/internal_market/company/ecgforum/index_en.htm

4.1. Application of the Comply-or-Explain Principle in Europe

The Forum discussed the general principle of "comply-or-explain" which guides the application of national and international corporate governance codes under three aspects:

- (1) The scope of the principle, the conditions that permit the principle to work effectively, including the extent to which formal regulation appears necessary;
- (2) Possible enforcement mechanisms in the different national legal environments;
- (3) Specific issues related to potential conflicts, i.e. cross-border situations where different codes can apply to one and the same company.

A high level of transparency, the ability of shareholders to hold boards (unitary or dual) ultimately accountable, and a clear understanding of the limits of the principle were identified as three factors of paramount importance to render the principle effective. Consequently, it was established that an appropriate legal framework is needed that ensures that the obligation to "comply or explain" is respected in practice.

The Forum will issue a general statement on the "comply-or-explain" principle.

4.2. Shareholders' rights

The Forum analysed the current Commission initiative aiming at facilitating the exercise of shareholders' voting rights. It recommended to the Commission to propose a directive in this area, as an effective exercise of shareholders rights is essential to good corporate governance practices. Given the large differences in legal systems and practices, the Forum suggested adopting a principle-based approach. However the Forum emphasized the need to find, in cooperation with financial institutions, a european-wide practical and effective way to develop cross-border voting.

The Forum, moreover, decided to contemplate the role of shareholders in the company on a broad basis. It does not seem appropriate to define a uniform role for shareholders in a company taking into account the differences in the national legislations and cultures and in shareholder structures. However, the current situation in the different Member States should be looked at more closely. On the basis of such an analysis it may be possible to identify certain best practices, the application of which could be encouraged within the EU.

The Forum members have generally identified the powers which should be granted to shareholders in order to ensure a high level of corporate governance. In this regard, the Forum identified in particular the right to appoint and dismiss executive and non-executive directors in the case of a one-

tier board structure and supervisory directors in case of a two-tier board structure, the right to vote on large transactions, the right to vote on alterations to the capital structure, the right to pre-emption and the right to vote on modifications to the articles of association. However, the Forum observes that there is insufficient factual information on the situation in the Member States. This same observation has already been made by the Transatlantic Corporate Governance Dialogue in September 2005, referring specifically to the shareholders' right to dismiss directors. The Forum therefore decided to carry out additional research on this topic (see point 5 below).

The Forum also considered the Commission's intention to commission an outside study on the issue of "one share – one vote". The Forum unanimously agreed on the need for a study that should follow an objective approach and be of high quality. The Forum considered that it should be actively associated to the determination of the terms of reference of the study as well as its practical conduct.

4.3. Internal control

The Forum discussed current developments of internal control in the EU. In view of the US experience, members agreed that a careful examination of the lessons to be drawn from experience should be carried out before considering any further legislative measure. There was agreement that an adequate balance should be ensured at any time between the benefits of additional legal requirements and the potential costs and burdens for companies. Therefore, the Forum advised unanimously against the imposition of an obligation for boards to certify the effectiveness of internal controls. However, most members took the view that the increase in disclosure requirements that will be introduced by the forthcoming modifications of the 4th and the 7th Company Law Directives constitute important steps towards improving corporate governance. Disclosure requirements do not only provide for transparency but they also ensure that the companies' boards effectively lead regular discussions on these subjects and, therefore, keep them under review.

The Forum also discussed the outcome of the event conference on Risk Management and Internal Control that was organised on 25 October 2005 in Brussels by the European Federation of Accountants (FEE) following its consultation launched in March 2005. The views expressed at the conference⁴ supported the Forum's own conclusions. Thus, participants shared the Forum's concerns about the costs of the US approach to internal control and also at the conference no calls were made for the introduction of an effectiveness statement or of public reporting of auditors. However, just as the Forum also the conference participants felt that work in the field should go on in order to keep close track of the developments.

⁴ information available under http://www.fee.be/news/default.asp?library_ref=2&content_ref=518

4.4. Other issues discussed in 2005

The Forum also discussed other EU initiatives in the field of corporate governance. Thus, it followed the developments on the 8th company law Directive on statutory audit of annual accounts and consolidated accounts where an agreement at EU level was reached in October 2005, on the modification of the 2nd company law Directive on the legal capital of companies and the project for a study that should examine possible alternative systems of capital maintenance. Furthermore, it took note of the Commission's intentions to launch a consultation on the mid and long term measures contained in the 2003 Company Law Action Plan. The consultation document was published on 20 December 2005⁵.

5. OUTLOOK TO 2006

The Forum will hold three meetings in 2006. These have provisionally been scheduled on 20 January, 1 June and 9 November.

The objective of the work in the coming year will be to reach substantial conclusions on the questions set out above.

To this end, the following will be the Forum's next steps:

- On the *principle of "comply-or-explain"* steps will be taken to link the Forum's work with that of national bodies following the implementation of the corporate governance codes existing in their Member State. The aim of this exchange of information will be to identify common issues and to determine how the different mechanisms can work in practice.
- In the field of the *role of shareholders* the Forum will, *inter alia*, continue to examine the “one share one vote” concept: As already mentioned, the Commission, early in 2006, will launch a study on the question of proportionality between capital and control. The Forum intends to provide input for setting the frame of this study and to accompany it through appropriate measures. To this end, a working group will be established within the Forum. The working group will, *inter alia*, contemplate the possible organisation of a conference on this topic

On the role of shareholders, the Forum also intends to discuss the issue of identity's disclosure, the voting process of financial institutions and the impact of stock lending.

The Forum also intends to discuss the role of other stakeholders (e.g. employees) in the corporate governance process. In addition, the Forum

⁵ http://europa.eu.int/comm/internal_market/company/consultation/index_en.htm

will continue to track the measures taken to implement the Commission's work programme.

As regards *internal control* for the moment there appears to be no need for taking concrete further steps. The Forum will keep under review whether the current approach is proving sufficient to ensure that internal controls within the EU meet best practice.

Finally, the Forum will aim at reinforcing its contact with other important actors, such as Members of the European Parliament.

European Corporate Governance Forum

List of Members

- Antonio BORGES
- Igor Adam CHALUPEC
- Bertrand COLLOMB
- Gerhardt CROMME
- David DEVLIN
- Emilio GABAGLIO
- Jose Maria GARRIDO GARCIA
- Peter MONTAGNON
- Colette NEUVILLE
- Roland OETKER
- Alastair ROSS GOOBEY
- Rolf SKOG
- Andres TRINK
- Jaap WINTER
- Eddy WYMEERSCH