Eurosif Response to the EU Green Paper on Corporate Governance in Listed Companies

DRAFT FOR MEMBER AFFILIATES July 2011

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Answers to consultation questions:

(A) General questions

(1) Should EU corporate governance measures take into account the size of listed companies? How? Should a differentiated and proportionate regime for small and medium-sized listed companies be established? If so, are there any appropriate definitions or thresholds? If so, please suggest ways of adapting them for SMEs where appropriate when answering the questions below.

Yes. Eurosif believes that EU corporate governance measures should be tailored to take into account the size of listed companies. Smaller companies are faced with different structures than larger companies and applying the same measures to both categories would prove inefficient and burdening for smaller companies. Imposing the same minimum number of independent directors for both large and smaller companies is an example of measure that is less relevant for a smaller company but highly recommended for a large one.

Member State corporate governance codes could serve as an example of corporate governance principles tailored for large and smaller companies (France, UK).

(2) Should any corporate governance measures be taken at EU level for unlisted companies? Should the EU focus on promoting development and application of voluntary codes for non-listed companies?

Yes, Eurosif is supportive of possibly having recommendations for corporate governance in unlisted companies, but not legally binding measures. While corporate governance codes are healthy to help ensure business long term continuity and success (considering the small number of shareholders or family ownership in non-listed companies), Eurosif considers that there should not be directive-level corporate governance measures for non-listed companies.

Eurosif recommends that the EC take explore the possibility of a set of Corporate Governance recommendations for non-listed companies, as already done in some EU Member States (Belgium, Finland, and UK).
(B) Boards of Directors

(3) Should the EU seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officer are clearly divided?

Yes. Some of the existing guidelines\(^1\) in Europe already recommend the clear separation of the Chairman of the Board and the Chief Executive Officer. Eurosif considers that the tenure of these two functions by one person should clearly be prohibited in listed companies as there must be a clear distinction between the management of the institution (ensured by the CEO and the Executive Board) and its governance (ensured by the Board of Directors) to prevent any conflicts of interests, and/or too much power in the hands of one person.

This recommendation follows Eurosif response to the public consultation on corporate governance in financial institutions (2010).

(4) Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how could that be best achieved and at what level of governance, i.e. at national, EU or international level?

Board recruitment policies should be left to each company to decide regarding the profile of directors, in order to ensure the diversity of skills, background and experience. Nevertheless, the selection process should be transparent and recruitment based on objective criteria. Board nomination committees are also a good corporate governance measure to ensure that board member recruitment is done fairly and in a transparent manner.

Regarding the level of governance, Eurosif believes that the exact recruitment policies should be subject to national implementation and less to European or international.

(5) Should listed companies be required to disclose whether they have a diversity policy and, if so, describe its objectives and main content and regularly report on progress?

Yes, companies should be required to disclose their diversity policy on a comply-or-explain basis. Diversity of board member experience skills, competencies and gender helps investors better understand the company practices on the subject when making investment decisions and are relevant for other stakeholders too.

(6) Should listed companies be required to ensure a better gender balance on boards? If so, how?

Yes. Gender balance is still an issue across Europe as shown in various studies and reports. A study conducted from 2005 to 2009 showed that the gender balance within the Boards of internationally operating companies only slightly increased in the favour of women participation, with just 26% of companies having more than 20% women in their Boards of Directors.\(^2\) More recently, a study run by the Cranfield School of Management showed the weak representation of women as executive or non-executive directors.\(^3\) Eurosif recommends that the European Commission establish mechanisms to increase gender equality in listed companies.

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\(^2\) According to a study carried out by Ernst&Young in partnership with Le Monde and Die Zeit. Available at this [link](#).

\(^3\) According to the study, in 2010 women made up only 12.5% of directors of the FTSE 100 companies. Only 5.5% of FTSE 100 executive directors were women. These executive director positions are typically the most senior and hands-on roles in companies, such as chief executives or chief financial officers.
(7) Do you believe there should be a measure at EU level limiting the number of mandates a non-executive director may hold? If so, how should it be formulated?

Eurosif does not agree that limiting the number of board memberships is the solution to greater time involvement. Such a measure might prove to be arbitrary and inflexible. Nevertheless, Eurosif agrees that sufficient time allocation by board members is an issue and has to be tackled by each company according to its needs. As suggested by currently existing guidelines in Europe, Eurosif contends that non-executive directors should have the ability to allocate greater time commitments for their respective boards.

As such, we recommend other measures that could ensure greater time commitment by director such as setting time-commitment expectations (weekly/monthly/yearly) in director appointment letters. Transparency of time-commitment expectations and evaluation of board attendance should be ensured effectively.

(8) Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)? If so, how could this be done?

Yes, Eurosif believes that the EC should establish mechanism to encourage companies to conduct a periodical external evaluation, as a healthy measure to evaluate corporate governance practices by a third objective party.

In addition to what already exists in the EU regulation on corporate governance (Directive 2006/46/EC), Eurosif recommends that the EC formulate a series of Corporate Governance Recommendations which would gather measures such as the external evaluation and other topics which could be subject to recommendations rather than to regulation.

(9) Should disclosure of remuneration policy, the annual remuneration report (a report on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors be mandatory?

Yes. Considering that one of the aims of remuneration is to incentivise and reward appropriate performance, risk management and behaviour (both short and long term) Eurosif believes that there should be increased transparency of remuneration for directors of both financial institutions as well as for all listed companies to shareholders.

As shown in the evaluation report on the application by the EU member states of the Remuneration Recommendation EC/2009/384, only 8 EU Member States fully implement the recommendations related to disclosure of the remuneration policies. As illustrated in the above mentioned Recommendation, the control of the design and implementation of the remuneration policy is more likely to be effective if the relevant stakeholders are properly informed and engaged in the process. To this end, Eurosif considers that the remuneration policies in all financial institutions should be fully transparent both internally and where relevant, to their shareholders. Furthermore, Eurosif considers that the disclosure to the shareholders of the decision making-process used for determining the remuneration strategies should be mandatory.

Furthermore, Eurosif strongly recommends that the EC explore how executive remuneration policies are linked to long-term performance, including to environmental, social and governance (ESG) targets. As such, Eurosif's position is that remuneration strategies should be linked to ESG performance based on a “comply or explain approach” whereby companies disclose the extent to which ESG targets are incorporated or explain the lack of ESG targets integrated in remuneration strategies.

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(10) Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?

Yes, shareholders should have an opinion on company top executive remuneration. Greater involvement of relevant stakeholders in the design and implementation of remuneration policies is more likely to create an effective control over the process. To this end, shareholder involvement in the remuneration policies is important. Eurosif considers that a shareholder vote on Directors’ remuneration packages should become mandatory at an EU level, as recommended in the EC Recommendation 2009/385/EC complementing Recommendations 2004/913/EC and 2005/162/EC.

(11) Do you agree that the board should approve and take responsibility for the company’s ‘risk appetite’ and report it meaningfully to shareholders? Should these disclosure arrangements also include relevant key societal risks?

Eurosif considers that the board should have greater involvement in overseeing the company’s risk appetite and risk management processes. Regarding societal risks, Eurosif strongly considers that reporting the environmental, social and governance (ESG) risks and how they are controlled should be mandatory for companies, along with the disclosure of financial risk control methods.

Initiatives such as the Transparency Directive\(^5\) make the periodical financial reporting compulsory for companies; however, non-financial data disclosure (ESG) remains the decision of companies which slows the progress in the field.

(12) Do you agree that the board should ensure that the company’s risk management arrangements are effective and commensurate with the company’s risk profile?

Yes, this is one of the responsibilities that the board should take greater involvement in. The relevance and effectiveness of risk management arrangements is vital to ensuring results.

As to the exact mechanisms of ensuring the risk control duty by the Board of Directors, Eurosif considers that this should be left to each company to decide (i.e. setting up risk-committees, internal reporting procedures, etc) as a “one size fits all” approach without taking into consideration the diversity of each institution can prove dangerous.

(C) Shareholders

(13) Please point to any existing EU legal rules which, in your view, may contribute to inappropriate short-termism among investors and suggest how these rules could be changed to prevent such behaviour.

Member Affiliates: please provide links to any current legal rules that may contribute to inappropriate short-termism among investors.

(14) Are there measures to be taken, and if so, which ones, as regards the incentive structures for and performance evaluation of asset managers managing long-term institutional investors’ portfolios?

Eurosif agrees that the agency relationship between institutional investors (asset owners) and their asset managers can have an impact on short-termism. Nevertheless, Eurosif wishes to acknowledge the

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\(^5\) The Transparency Directive is designed to enhance transparency on EU capital markets and is currently being modernised by the European Commission through a public consultation open between May 27-Aug 20, 2010. More details [here](#).
contribution of international initiatives and report to increasing asset owner active approach in overseeing investee companies. Reports such as the 2005 Freshfields report or the rise of voluntary initiatives such as the Principles for Responsible Investment have contributed to the integration of long-term considerations (ESG) into investment practices, both by asset owners and asset managers.

The asset manager evaluation mechanisms need to focus on longer term performance and the active involvement of long-term oriented investors is vital in this sense. To avoid encouraging asset managers to seek short-term benefits in managing investment contracts, Eurosif agrees that there are a series of additional measures that can be taken to encourage healthy incentive structures.

- To mitigate long-term risks, asset managers could be required to report how they assess environmental, social and governance (ESG) risks in their mandates; this includes areas from investee company selection to engagement methods;
- As part of investment management contracts, asset managers should also offer ESG options and advice for asset owners;
- Adherence to investor codes of practice on a comply-or-explain basis is another measure that can boost investor (and asset manager) transparency on how they manage investment mandates. Successful Member States example such as the UK Stewardship code could serve as a model for a pan-European code.

As a supporting argument, Eurosif wishes to point a recent report by UNEPFI’s Asset Management workgroup that revealed the necessity of embedding ESG issues in investment management contracts and statements of investment principles. The report also stressed on the need of periodic ESG-inclusive reporting by asset managers and the need for longer-term assessment of asset manager performance, better linked to long-term incentives.

(15) Should EU law promote more effective monitoring of asset managers by institutional investors with regard to strategies, costs, trading and the extent to which asset managers engage with the investee companies? If so, how?

Yes. Eurosif strongly recommends that the EU promote more effective monitoring of asset managers by institutional investors, where there is the need. One of asset owners’ responsibility is to cope with long-term risk of investee company performance and as such they need to ensure that asset managers’ engagement with investee companies serve these long-term strategies and risks. Transparency and reporting on the performance of fiduciary duty by asset managers is an important outcome that needs to be ensured and the suggestions under Q14 could help provide this.

(16) Should EU rules require a certain independence of the asset managers’ governing body, for example from its parent company, or are other (legislative) measures needed to enhance disclosure and management of conflicts of interest?

Yes. Where asset managers are owned by a parent asset owner company, independence must be ensured and any possible conflict of interest should be disclosed, as a mandatory EU requirement. Eurosif agrees that conflicts of interest are likely to arise when an institutional investor or asset manager or its parent company has a business interest in the investee company. Therefore, Eurosif strongly recommends that there is mandatory disclosure of any possible conflict of interest. Ideally, asset owners should opt to sell out asset management arms to ensure totally avoiding possible conflicts of interest (some asset owners are adopting this option, one of the latest examples being Lloyds Banking Group who consider selling their asset management arm for various factors).

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7 Source FTfm, May 22, 2011: http://www.ft.com/intl/cms/s/0/cea4f54e-8450-11e0-a1cb-00144feadbc0.html#axzz1R9BRXJiB
The feedback received by the EC to the 2010 public consultation on corporate governance in financial institutions could also serve as a basis for possible measures to manage conflicts of interest at the EU level.8

(17) **What would be the best way for the EU to facilitate shareholder cooperation?**

When talking about shareholder cooperation, additional topics need to be taken into consideration and included in the debate, such as the ability of shareholders to engage at all in the voting process. Eurosif Member Affiliates have raised the issue of operational processes by which shares are voted and the need to ensure that all possible bottlenecks are removed (for example, there have been cases reported where investors have been required by intermediary voting agents to make voting decisions on meetings for which agendas have not been finalised on voting deadline day). This is only an example of possible issues to be addressed that are linked to shareholder engagement and that are related partly to shareholder cooperation.

Eurosif supports better frameworks for shareholder cooperation and recommends that the EC explore the best ways of achieving this, while ensuring that shareholders cooperating to influence corporate governance practices does not fall under possible “acting in concert” claims.

Full implementation of the Shareholder Rights Directive is a means to ensuring that all shareholders across Europe enjoy the same rights when investing in companies.9 In the context of this Directive review, Eurosif would like to point to the investor letter sent to Commissioner Barnier in 2010, by ABI, Eumedion and Eurosif, addressing several shareholder rights issues.10

(18) **Should EU law require proxy advisors to be more transparent, e.g. about their analytical methods, conflicts of interest and their policy for managing them and/or whether they apply a code of conduct? If so, how can this best be achieved?**

Proxy advisor transparency raises issues especially in the case of lack of multiple sources of research and generic voting policies by investors. From the discussions with Eurosif Member Affiliates, several potential solutions can be envisaged to address proxy advisor transparency:

Voting advisors should disclose whether they make generic voting recommendations (“in-house voting advice”) for each meeting. If they do, then they should indicate what proportion of the voting instructions they send on behalf of their customers are voted automatically in line with in-house voting advice (i.e. determined, confirmed and instructed by the voting advisor without the need for confirmation by the investor). Also, proxy advisors should indicate the proportion of the voting instructions voted in line with in-house voting advice (but confirmed by the investor prior to instruction) or voted differently to in-house voting advice, either because the investor has made a different decision despite the in-house advice, or they have a custom policy.

Where the advisor provides more than one set of in-house voting advice (e.g. where they have a generic 'SRI' voting policy), they should break down the above proportions on a per-policy basis, showing all proportions in terms of total votes processed by them.

The principles underlying in-house voting advice should be made available to issuers and investors making use of them. However, advisors should be given discretion to divert from their voting policy on specific recommendations, provided they offer an explanation for why they have done so.

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8 Summary of responses can be found at: [http://ec.europa.eu/internal_market/company/modern/corporate_governance_in_financial_institutions_en.htm](http://ec.europa.eu/internal_market/company/modern/corporate_governance_in_financial_institutions_en.htm)

9 As of 2010, only 19 Member States fully implemented the Shareholder Rights Directive, with Member States (Belgium, Cyprus, Greece, Spain, France, Luxembourg, The Netherlands and Sweden) still have to implement some or all of its provisions.

Do you believe that other (legislative) measures are necessary, e.g. restrictions on the ability of proxy advisors to provide consulting services to investee companies?

Conflicts of interests where proxy advisor clients are shareholder proponent can potentially raise issues, but rather than additional legislative measures, we believe there is a scope for a code of conduct between the proxy agents, issuer and proponent to clarify rights, responsibilities and boundaries of interest to ensure effective conflict management.

Therefore, Eurosif recommends that proxy advisors should prominently disclose in meeting analysis where (1) the target (issuer) company is a customer, and what services they use, (2) the research and/or recommendations have been vetted by the target company prior to publication and (3) a resolution is proposed by a customer of the proxy advisor, and what services they use.

Do you see a need for a technical and/or legal European mechanism to help issuers identify their shareholders in order to facilitate dialogue on corporate governance issues? If so, do you believe this would also benefit cooperation between investors?

The existing rules are sufficient.

Do you think that minority shareholders need additional rights to represent their interests effectively in companies with controlling or dominant shareholders?

Minority shareholders primarily need protection from controlling dominant shareholders and Eurosif recommends that the EC explore how EU Member States current examples can be replicated at the EU level (for example, the Italian one) which can enhance minority shareholder protection.

Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?

Eurosif recommends that the EC explore how the European Corporate Governance Forum Statement on Minority Shareholders can be adopted at the EU level.¹¹

Are there measures to be taken, and is so, which ones, to promote at EU level employee share ownership?

Eurosif recommends that the EC explore how already existing employee share ownership standards in some EU Member States can be standardized at the EU Level.¹²

Monitoring and implementation of Corporate Governance Codes

Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?

Yes. The “Explain” element of the “comply or explain” approach is vital in ensuring this approach effectiveness. The current EU legislation on corporate governance requiring the inclusion of a corporate governance report in annual statements favours a “comply or explain” approach and Eurosif considers that corporate governance should remain under this regime.

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In the case that there isn't enough information provided by companies that chose to depart from certain corporate governance principles, the EC should ensure that there are specific mechanisms in place to ensure this. Implementation guidelines and better monitoring at the EU Member States level or at the EU level could enhance the quality of the information provided.

The example of already established corporate governance codes on a mandatory “comply or explain” approach (UK Stewardship Code) should serve as an EU example of effective corporate governance principle implementation (as proven so far).

(25) Do you agree that monitoring bodies should be authorised to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If yes, what exactly should be their role?

Yes. Monitoring bodies should be authorised to check the informative quality of the explanations in corporate governance statements. Moreover, shareholders (as company owners) should be the main actors evaluating the quality of corporate governance statements by effectively engaging in dialogue. Nevertheless, having both shareholders and external monitoring bodies could prove effective for ensuring the quality of information in corporate governance statements.

13 It is our understanding that the EC draws from recent EU studies that in 60% of cases, there isn’t sufficient explanation when companies chose not to apply corporate governance code recommendations.
APPENDIX

About Eurosif

EUROSIF, the European Sustainable Investment Forum, is the pan-European network whose mission is to develop sustainability through European financial markets. Eurosif works as a partnership of the national Sustainable Investment Forums (SIFs) within the EU and with the support and involvement of Member Affiliates. Recognised as the premier European forum for sustainable investment, Eurosif's Member Affiliates are drawn from leading pension funds, asset managers, NGO’s, trade unions, academic institutes and research providers, together representing assets totalling over €1 trillion. Eurosif's work includes a focus across asset classes - equity and fixed income markets, microfinance, renewable energy, property, private equity and hedge funds - all centred around the industry trends and future legislation affecting this space. The key benefits that Eurosif affiliate members receive include EU interfacing; SRI information and European wide initiatives that integrate Environmental, Social and Governance (ESG) issues into the financial services sector.

For the full list of Eurosif Member Affiliates, please see www.eurosif.org

Eurosif has two main roles: (1) to provide an international forum that allows members and member affiliates to work together on issues pertaining to Sustainable & Responsible Investment (SRI, see below for definition of SRI and its market size in Europe) and Corporate Governance in the EU financial services sector, and (2) to collect input from members and member affiliates and then communicate their ideas and initiatives to European policy makers, including the European Commission as well as the European Parliament. Therefore, this note is mainly driven from and by the interest and expertise of our membership.

Sustainable and Responsible Investment Definition

Eurosif continues to use the term “SRI” as the most readily acknowledged expression for this field and defines SRI as follows:

SRI, a generic term covering ethical investments, responsible investments, sustainable investments, and any other investment process that combines investors' financial objectives with their concerns about environmental, social and governance (ESG) issues.

To do so, different approaches exists:

- **Best-In-Class approach**: Selection of the best companies in their sector with regard to sustainable development.
- **Thematic approach**: Selection of the best companies according to a specific sustainable development theme (renewable energies, water, job creation, etc.).
- **Norms-Based approach**: Selection of companies according to their observance of the main international treaties/conventions (e.g. ILO).
- **Exclusion approach**: Exclusion of companies involved in controversial activities or issues (alcohol, gambling, animal testing, etc.).
- **Engagement**: this includes proxy voting, collaborative engagement, direct private dialogue with companies, and public engagement. Engagement is often considered as an extra overlay to other SRI approaches or traditional management.
- **Microfinance approach**: financing Microfinance institutions (bonds or equity) favoring economic empowerment.

Market Size

In its latest European SRI Study 2008, Eurosif published the latest Sustainable and Responsible Investment (SRI) figures and trends. The 2010 edition of the SRI Study will be published on October 13, 2010. This unique study will highlight the scale of European SRI as well as European and National trends across eighteen countries. Based on a survey of asset managers and self-managed asset owners, Eurosif assessed the total European SRI assets under management (AuMs) to be €2.7 trillion as of December 31, 2007 and represent as much as 17.5% of the asset management industry in Europe.