



**European Commission's Green paper
"The EU corporate governance framework"
[COM(2011) 164 final]**

**CEC European Managers Position
July 2011**

Preface

CEC :

- . believes that a good corporate governance cannot be reached if the methods, the objectives and the practices are not fully understood by all stakeholders within companies.
- . promotes a greater involvement of employees, and, in particular, of managers, in the awareness-raising and in the assessment of governance within their company.
- . believes that the role of the EU should be limited to monitoring and benchmarking the development of the national corporate governance systems. This may also include non-binding policy recommendations. The already existing European Corporate Governance Forum fulfils this role in a satisfactory manner. Beyond this, CEC sees no need for tightening European regulation. In other words, neither a "European Corporate Governance Code" (as a long-term goal) nor a "European Code for National Corporate Governance Codices" (as a short-term goal) is deemed necessary.
- . calls on the Commission to stick to its neutral approach towards the variety of governance and board systems, especially to refrain from favouring specific governance type over others. This applies in particular to the alternatives of monistic and dual systems of governance.

(Q1) 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.

. Considering the wide diversity in terms of size and structure among listed companies (highlighted for instance by the first report of November 2010 on the implementation of the corporate governance code for companies of MiddleNext in France¹), CEC pushes for the inclusion of company size criteria in the European rules on corporate governance. Indeed, European rules should not put excessive administrative burden on small and medium-sized listed companies. If the company-size criterion is taken into account in European measures, it will be easier to have corporate governance rules accepted by all companies. Furthermore, there could be a spillover effect: if SMEs apply corporate governance principles tailored to their specific situation more easily, then larger companies will be encouraged to implement the EU recommendations further.

. Nevertheless, from CEC's viewpoint, a differentiated and proportionate regime should not be created specifically for SMEs, as a broadly-accepted definition of such a regime will be very difficult to reach. The European Union in any way should not have more than one corporate governance framework. CEC rather recommends having a cross-cutting rule establishing the need to take into account the specific situation of listed SMEs, which could be included in every new European rule on corporate governance. Thus, the flexibility of national corporate governance codes would be preserved, thus ensuring that the specificities of SMEs are better taken into account.

¹ Available on: <http://www.middlenext.com/spip.php?article645>

(Q2) 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?

. From CEC's perspective, the diversity within unlisted companies is larger than the one existing within listed companies. In consequence, a legal framework adopted at the EU level seems unrealistic considering the need to adapt corporate governance principles to specific conditions and situations faced by non-listed companies.

. However, CEC welcomes the EU's proposal to promote the development of voluntary codes for non-listed companies in the Member States. Although excessive control on the application of corporate governance rules by unlisted companies should be avoided, the protection of shareholders should be understood in the broadest sense to ensure protection within these companies as well. Having in mind the economic weight of non-listed companies (75% of the EU's GDP), and knowing the impact corporate governance has on trust in the professionalism and investments of companies, CEC pushes for a dissemination of corporate governance principles among non-listed companies. The application of corporate governance rules is a step by step process, and therefore CEC supports above all a flexible and pragmatic approach towards the implementation, i.e. through recommendation at national level.

(Q3) 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?

. From CEC's perspective, a clear division between the respective duties of the chairperson of the board of directors and of the chief executive officer must be encouraged, in order to ensure a greater efficiency in the management of companies, whatever the structure chosen (monistic or dual system) and the size of companies. The division of functions and duties of stakeholders within companies should be considered as a cornerstone among corporate governance principles: good governance entails at least the possibility for boards to question decisions related to the company's management.²

. However, it will be difficult to accommodate a strict system at European level with the need to take into account the specific situation of listed SMEs and the flexibility of national corporate governance codes. The didactic dimension introduced by national corporate governance codes raises companies' awareness on the need to change their governance systems. Therefore, promoting this didactic dimension would be more efficient, as the report on the implementation of the French corporate governance for MiddleNext companies illustrates: 2/3 of the companies which have adopted the MiddleNext code now have separate functions, regardless of the structure of their management. Nevertheless, in case of non-compliance to the recommendation, a clear explanation should be at least included in the annual report.

² Therefore, dual structure should be generally favoured.

(Q4) 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?

. Generally, CEC welcomes every new EU initiative aiming at improving diversity within companies. Regarding the composition of the board, it is clear that directors and the chairman should have the skills required for such positions, in order to ensure viable and sustainable development policies for companies.

. Nevertheless, the corporate governance principles should not lead to weaken the power of decision of shareholders regarding the recruitment of directors. Shareholders are the primary decision-makers in the process of recruitment, and as such should not be forced by too specific rules. CEC believes that general guidelines adopted at the different levels of governance targeted by the European Commission (at national, EU or international level) would be counterproductive, as the diversity of needs and situations among companies requires the greatest flexibility in the recruitment of directors. The answer to the question what skills should be represented in a company's board has to be answered individually for each company, depending on its branch, its competitive environment, its history etc. The EU's role should not be to try to micro-regulate questions that lie within the companies' key business interests.

. Beyond that, policy recommendations by the EU must bear in mind that in governance systems with employee participation, the employees' rights to elect their representatives in the board cannot be compared to a recruitment process. CEC traditionally views the presence of employees on the board (especially of highly skilled or managerial employees with detailed knowledge of internal processes of a company) as an inherent contribution to a broader diversity of profiles and to a good decision-making quality in corporate boards.

. Therefore, the EU's role must be limited to the promotion of principles guiding the recruitment policies, which should be inserted in corporate governance codes. There is still a room for improvement without using rigid rules: for example, the practice of appointment committees composed of independent directors could be a way of progress.

(Q5) 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?

. There is well-established evidence that employee diversity has a positive impact on the working environment, the corporate image, the creativity and thus competitiveness. Diversity policies also increase employees' motivation and loyalty, and should therefore be seen by companies as a real competitive advantage.

. Thus, CEC is rather in favour of the implementation of a diversity policy within listed companies, in particular as regards the gender dimension. For instance, binding rules leading listed companies to better disclose the implementation of diversity policy in their annual report would be a positive initiative³ (for instance, in line with the principle of comply or explain, enterprises should explain why

³ The French legislation could be used as a benchmark: the law on New Economic Regulations adopted on 2001 made the disclosure of information on professional equality between women and men, as well as information on corporate commitments in favour of diversity and fight against discrimination, compulsory for listed companies (in their annual report submitted to the general meeting of shareholders; Article L225-102-1 of the French code of commerce). This rule will soon apply to non-listed companies, which should thus disclose data on gender pay gap and report annually on the situation of women and men within the company.

they don't have women on the top and what have they done to attract them). CEC also promotes the publication within companies of a Charter on Diversity, Gender Equality and Equal Opportunities.⁴

(Q6) Should listed companies be required to ensure a better gender balance on boards? If so, how?

. For many years, CEC has undertaken initiatives and actions aiming at establishing effective gender equality within companies, and in particular in decision-making positions. Indeed, as an organisation promoting managers interests, CEC is especially aware of the gender gap in these positions and follows closely the issue of «glass ceiling ». Therefore, CEC considers that the European institutions and the social partners should encourage listed companies to ensure a better balance between men and women in their boards. Beyond that, the European Commission should have a systemic approach to address the issue of women's proportion in managerial positions (high, intermediary or low level).

. Nevertheless, CEC does not support strict rules of mandatory parity within boards. CEC rather recommends the promotion of the concepts of diversity, complementarity and the recognition of skills and competences. This approach contributes to perceive gender equality as a matter exceeding women's interests solely and increases the awareness of every actor on this topic. Instruments targeted at promoting the accession of women to higher management levels should have priority (this includes the regulation of working time and promotion criteria, the promotion of training and mentoring, the signature of equality label by companies...).

. Therefore, CEC welcomes the European Commission initiative to launch a voluntary pledge to increase the number of women in top positions for European listed companies.⁵ CEC believes that raising awareness through the promotion of best practices will lead to general progress of all companies in this respect and highlight the positive link between gender policy and corporate performance.

(Q7) 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?

. CEC shares the European Commission's concern regarding the necessary availability of non-executive directors to fulfil their duties. CEC is rather in favour of limiting the number of mandates a non-executive director may hold. This might also include the addition of mandates held in different countries (within and beyond the EU). Besides a relevant measure limiting the number of mandates, it could be foreseen to reduce the financial remuneration arising from these mandates: holding of several mandates concurrently could engage tax disincentives increasing with the number of mandates.

. However, considering the wide diversity of national situations previously mentioned, it does not seem appropriate to legislate on that point at EU level. The European Commission acknowledges in its Green paper that certain Member States already recommend or even limit the number of

⁴ Studies show that this tool can be efficient in improving awareness on the issue of diversity within companies: «According to companies that took part in the research, several areas of diversity and business activity benefited from signing the diversity charter. In relation to diversity activity, the majority (73%) identified increased levels of internal awareness. A further 50% identified an improved reputation of the company's commitment to diversity, and 47% witnessed an increased commitment of management to diversity issues». Study of the DG for Employment, Social Affairs and Equal Opportunities: "Continuing the diversity journey; business practices, perspectives and benefits", 2009, p.39.

⁵ « Women in the board pledge for Europe », launched by EU Commissioner Viviane Reding on March 2011.

mandates for non-executive directors.⁶ Therefore, the European Commission should simply promote through recommendation a wider recognition of this matter by national legislation or national corporate governance codes, before considering European legislation. In Member States where national authorities consider that it is impossible to set a relevant limit, the possibility to let the matter in the hands of companies must be kept.

(Q8) Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)? If so, how could this be done?

. Considering the experiences with the current economic and financial crisis, it is indisputable that the improvement of the assessment process of each board member and of the performance of the board as a group should be ensured. Therefore, an external evaluation conducted regularly could be a way of progress, as noted by the European Commission, and should be encouraged as a complementary possibility.⁷ The specific situation of listed SMEs should also be taken into account, for instance via a longer period between two evaluations (e.g. every five years).

. However, from CEC's perspective, the task of assessing the boards is primarily in the hands of directors of listed companies, and as such an external evaluation should not become a binding rule in the future.

. CEC also believes that progress in the internal evaluation of the boards could be obtained by an increasing involvement of employees in this process. Thus, CEC pushes for the establishment at EU level of a mandatory opinion of employees' committees on the annual report of listed companies with such internal committees.⁸ If employees can directly take part in the governance mechanism within their companies and have their opinion taken into account through internal evaluation, this may also contribute to increasing employee motivation and commitment.

(Q9) 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?

. CEC supports the recent trend among Member States to favour the mandatory disclosure of the remuneration policy of listed companies. Not only shareholders but also employees and other stakeholders have a legitimate interest in gaining access to this information. They must be well informed to properly discuss the remuneration policy and ask for necessary justification by directors, including information on pension plans which are a currently important element of corporate pay. To be fully efficient, sanctions could be foreseen in case of recurring non-compliance: for example, if the company does not comply with this mandatory rule during three years, it could be forced to pay a financial penalty.

. Nevertheless, CEC believes that the disclosure of individual remuneration should not be extended to managers below the board level. Indeed, a mandatory disclosure of the earnings perceived by directors may put pressure to a wider disclosure of information concerning remuneration policies. Yet, CEC stresses that the long-term management responsibility of listed companies is borne

⁶ For instance, German companies set a limit to the number of seats in supervisory councils since 2006. Criticised at first, this rule has become broadly accepted and is mostly seen as a contribution to better corporate governance.

⁷ CEC notes that the payment of the external facilitator could be a problem. In the contrary of the European Commission which underlines in its Green paper that « regular use of an external facilitator [...] could improve board evaluations by bringing an objective perspective [...] », CEC considers that a payment by the company leads necessary to a lack of objectivity.

⁸ At least, the Commission should support interested countries in running pilot schemes to test the idea.

primarily by executives and non-executive directors. Furthermore, disclosure of individual remuneration of managers might be a competitive disadvantage for companies in the search of high-profile managers. Therefore, the disclosure of earnings should be limited to directors.

(Q10) Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?

. CEC is aware of the conclusions that the European Commission drew in its report on the implementation by Member States of the recommendation 2009/385/EC on directors' remuneration⁹, namely that a minority of Member States promotes the shareholders' vote on the remuneration statement. However, CEC feels that it should be left entirely to the discretion of Member States as to follow this recommendation or not. In Member States where the experience is positive¹⁰, the mandatory vote should continue to be promoted and possibly enhanced.

. On the one hand, in some cases the shareholders' vote may be an important element for the implementation of adequate remuneration policies and the reduction of the mismatch between performance and responsibilities of directors. However, a mandatory vote by shareholders should not be established at EU level. It might be kept as an option, and the current choice between binding and consultative vote must be preserved too.

. On the other hand, a vote on the remuneration report during the shareholders' meetings can also entail serious risks. It undermines a core task and responsibility of non-executive directors/supervisory boards, namely the fixation of the remuneration of executive directors/executive boards. There is also the risk that professional plaintiffs use the media attention during shareholders' meetings to put pressure on the boards and thus seeking their own financial interests without any legitimate cause against the companies' board(s).

. From CEC's viewpoint, there is no reason for questioning the boards' legitimacy to take this decision. After all, the supervisory boards and the boards of directors assume the full risks associated with these decisions since they are always accountable to the owners in the shareholders meeting.

⁹ Report from the Commission to the European Parliament, the Council, the Economic and Social Committee and the Council of regions on the implementation by Member States of the EU of the Commission recommendation 2009/385/EC, complementing recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of the directors of listed companies, COM(2010) 285 final 2.6.2010.

¹⁰ In the United Kingdom for example.

(Q11) 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?

(Q12) 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?

. From CEC's viewpoint, the board should take responsibility for the management of the company's risk profile from the start, namely the definition of the risk management policy. CEC also promotes regular reports by the board to shareholders on how risks are monitored and managed, in order to regularly evaluate if risk management arrangements are effective and adequate.¹¹

. One solution to improve risk management's policy in a more fundamental approach might be to make the auditors responsible to the shareholders rather than to the board. However, this solution should be envisaged only in companies where a specific agreement has been concluded between the board and the shareholders.

(Q22) Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?

. From CEC's viewpoint, minority shareholders should be better informed about on-going or future related party transactions within companies they have invested into. The annual report could explicitly provide information on existing cash or material flows which have an impact on company's capital.

(Q23) Are there measures to be taken, and if so, which ones, to promote at EU level employee share ownership?

. CEC welcomes the European Commission support to employees' financial participation in their company. With the economic and financial crisis, the need to reinforce long-term interests of executive directors and investors has been brought to light, and a stronger financial involvement of employees is a possible way to reach this (either employees buy shares, or the company allocates shares to employees as an incentive). Employee share ownership could lead to a better supervisory control of the company's management by employees, and as such it could be a positive element for better corporate governance.¹² As mentioned by the Commission, such schemes are also means to increase the commitment and motivation of workers, and therefore are beneficial for raising competitiveness and company performance.

. From CEC's viewpoint, the European Commission should continue to regularly publish general reports commenting national systems of employees' national participation. As some studies showed¹³, a competitive process might result from the benchmarking and the analysis of good practices: indeed, economic stakeholders in countries where employees' financial involvement is less

¹¹ From CEC's viewpoint, the UK Corporate Governance Code of 2010 established proper and balanced rules on this question, which could be promoted as good practices. Thus, this Code « states that the boards of all listed companies are responsible for determining the nature and extent of the significant risks they are willing to take in achieving their strategic objectives. Boards are required to maintain sound risks management and internal control systems. [...] These are core principles which listed companies must comply with and report on to their shareholders. » B. Clarke, Conference on "European Company Law: the way forward", Brussels, 16-17 May 2011.

¹² In France for instance, if the shares held by employees represent 3% in the company, then French law requires that one member of the board of directors is appointed among employees.

¹³ See for example the study from Eurofound « Financial participation in the EU: indicators for benchmarking », 2004.

developed might be afraid to be out of competition, and therefore might be obliged to implement such systems.

. CEC also calls on the Commission to promote, for instance through a recommendation, stronger efforts from Member States towards the implementation of legal and fiscal incentives to employee share ownership. Indeed, one of the cross-national obstacles to employees' financial involvement identified in 2002 by the European Commission¹⁴ is the lack of incentives offered by certain national tax systems, while other Member States subsidize this mechanism.

. Furthermore, it must be ensured that employees are well-informed when companies open to stakeholders the opportunity to acquire company's shares. They must be treated in the same way as other investors in this process, regardless the amount of shares they could purchase.

. Notwithstanding the general support of CEC for financial participation schemes, Member States should also address a potential conflict of interest between occupational pension systems and employee participation systems. Companies should not go so far as to encourage their employees to completely neglect their retirement provisions and to rely solely on their companies' participation schemes. In order to prevent the risk of losing both job and assets in the case of insolvency¹⁵, contributions to financial participation schemes ideally should complement and not replace contributions to occupational (or private) pension schemes.

(Q24) 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?

(Q25) 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?

. CEC believes that the Commission's initiative in favour of a more binding application of the approach «comply or explain» goes too far. If the Member States were to move in the direction suggested by the Commission in question 25, this would alter the comply or explain mechanism fundamentally, especially its underlying principle that the implementation of recommendations of corporate governance codes is voluntary.

. The relation between clear requirements in national corporate governance codes and the quality of explanations is not well-established and proven, if for instance we compare the quality of the explanations given by Swedish companies and the information provided by French companies. Indeed, the proportion of informative explanations provided is the same in the two countries, while the French code for listed companies does not make any specific requirement¹⁶, unlike the Swedish corporate governance code¹⁷.

¹⁴ Communication from the Commission of 5 July 2002 « Framework for the employee financial participation », COM(2002) 364 final.

¹⁵ It is true that sensible risk management rather suggests that any investment should be in other companies, as employees already have a major investment in the company through their salaries.

¹⁶ Point 22 of the French Corporate governance code: « Listed corporations referring to this corporate governance code should report, with particulars, in their reference documents or in their annual reports, on implementation of these recommendations and, if applicable, explain the reasons why any of them may not have been implemented ». Regarding comparisons among Member States on quality of explanations see the study on Monitoring and Enforcement Practices in Corporate Governance in the Member States, mentioned by the Commission in the Green Paper (p.84 of the study).

¹⁷ As mentioned by the Commission in the Green Paper, the Swedish corporate governance code provides that "in its corporate governance report, the company is to state clearly which Code rules it has not complied with, explain the reasons for each case of non-compliance and describe the solution it has adopted instead".

Similarly, the description of the alternative solutions adopted should simply be encouraged. As acknowledged by the Commission, listed companies are still at a learning stage; therefore companies should have an opportunity to try themselves to apply the « comply or explain » approach more strongly.

. Certainly in some instances companies referring to these codes still need to improve the quality of their explanations in case of departures from the recommendations. The disclosure of detailed information may be encouraged by national codes, provided that there is a consensus on such a requirement in an individual Member State.¹⁸

. Nevertheless, CEC feels that Member States should refrain from introducing distinct formal legal requirements for the explanations given for non-compliance and especially any form of public supervision.

In this perspective, CEC believes that the possibility raised by the Commission in the Green Paper to reinforce certain requirements relating to the implementation of corporate governance recommendations at the legislative level, and in particular concerning the approach « comply or explain », is not appropriate. The flexibility required by the method “per se” invites at giving priority to recommendations on binding rules.

¹⁸ The French member organisation of CEC is thus in favour of improving the French corporate governance code requirements towards the disclosure of detailed information and the description of alternative solutions in case of departures.