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Confédération Européenne des Associations d'Administrateurs

European Confederation of Directors' Associations

March 2014,

POSITION STATEMENT ON SOME MAJOR CORPORATE GOVERNANCE QUESTIONS ADDRESSED TO THE FUTURE EUROPEAN COMMISSION and EUROPEAN PARLIAMENT

While the European Commission is preparing technical notes for the new Commissioners and their staff to be appointed and while (potentially new) MEPs started their election campaigns, the ecoDa board, acting as "the European Voice of Directors", would like to take the opportunity to address number of corporate governance issues we consider important and relevant to the European Business Community for the coming years.

We are convinced that the European Union's ambition to realize smart, inclusive and sustainable growth can only be reached when promoting and supporting sustainable and responsible businesses. To this end ecoDa, wants to **highlight the important contribution good governance can bring to professionalizing our European business firms, supporting their growth strategies while also facilitating growth financing and the succession or transmission of business firms**.

The ecoDa board therefore decided to submit a number of ideas that could help the European organizations to better grasp the governance priorities Europe is confronted with.

1. Board room professionalism – Optimizing boardroom dynamics and leadership, professional director development and board independence.
2. Duties and rights of shareholders – Promoting active & long term shareholdership
3. International level playing field - Finding the right balance between the need for further promoting the single European market while making optimal use of the rich diversity in governance models throughout Europe – Building more proportionality within the governance regulations.
4. Developing the right governance framework for different ownership structures and models.

In thanking you for your attention, we remain at your disposal for further discussion.
Yours sincerely

Patrick Zurstrassen, Chair
Lutgart Van den Berghe, Chair of the Policy Committee
Beatrice Richez-Baum, Secretary General

<u>About ecoDa:</u>

The European Confederation of Directors' Associations (ecoDa) is a not-for-profit association based in Brussels, acting since March 2005 as the "European voice of directors". Through its national institutes of directors (the main national institutes existing in Europe), ecoDa represents more than fifty thousand board directors from across the EU member states. ecoDa's mission is to promote good corporate governance and improve the effectiveness of boards of directors and/or supervisory boards, particularly by means of appropriate director training, professional development and boardroom best practice.

Our detailed proposals:

1- Improve corporate governance throughout Europe by focusing more on true board room professionalism and leadership behaviour

In previous years, the European institutions have devoted a great deal of interest to the promotion of good governance practices, through numerous directives, recommendations and Green Papers. As was the case in many other international jurisdictions, **most attention was given to the necessary structures (like boards) and procedures (like audit) in order to install governance practices that foster long-term success**. Although these are important steps, we at ecoDa are convinced that the final goal will never be reached unless we also promote more professionalism in the board room.

To this end, ecoDa is convinced that strict regulation will not be the ultimate desired solution, on the contrary it is merely monitoring from the inside that will need to be stimulated further. This does not mean that the European institutions should remain passive observers, on the contrary. **It would be good if the European politicians and decision-makers would support and even stimulate initiatives that aim at promoting the professional development of directors and of the boards' capacity of collective decision making.** ecoDa and its member organisations have built substantial expertise in developing education programmes for directors (some of them also certifying directors that successfully passed a set of professional education programmes) and mentoring programmes for candidate directors while also supporting the development of induction programs (to build sufficient business insights for directors).
Given the important role director institutes can play in promoting director education, ecoDa is looking for European support in the development of new director institutes in those member states where such organisations have not been installed yet (*see ecoDa reaction to EU GP on CG in listed companies*)[1].

Another important instrument to promote good governance practices is to put more emphasis on the right governance attitude (*see ecoDa reaction to EU GP on CG in financial sector, Report of ecoDa and IBE event of 2nd July 2013 on "Does EU Corporate Governance Need More Ethics?" as well as upcoming new work with IBE*)[2] and the most appropriate board dynamics by **stimulating more objective and robust board effectiveness reviews and individual director assessments** (*see ecoDa reaction to EU GP on CG in listed companies and reaction to EBA consultation*)[3].

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1 "ecoDa's response to the EU Green Paper on Corporate Governance for listed companies", June 2011, http://ecoda.org/uploads/media/PP_-_2011_06_29_CG_for_listed_companies.pdf

2 "ecoDa's response to the European Commission's Green Paper on corporate governance in financial institutions and remuneration policies", July 2010, http://ecoda.org/index.php?id=134 and Report of ecoDa and IBE event of 2nd July 2013 on "Does EU Corporate Governance Need More Ethics?" http://ecoda.org/uploads/media/REPORT_-_2013_07_15_IBE-ecoDa_Conference_on_Ethics_-_Event_Summary.pdf

3 "ecoDa's response to the EU Green Paper on Corporate Governance for listed companies", June 2011, http://ecoda.org/uploads/media/PP_-_2011_06_29_CG_for_listed_companies.pdf and

One important ingredient already included in the EU recommendations is the role of board independence. This was a first stimulus to 'a-priori' define board independence, but such approach should be complemented with **additional monitoring instruments and guarantees for effective board independence**. To this end one could look at the minimum norms for board independence (number or % of independent directors on boards and board committees), and to mechanisms for monitoring 'ex-post' the behaviour of independent directors (e.g. to be included in board and director assessments).

2- <u>Improve long-term sustainability in Europe by focusing more on the duties and rights of shareholders</u>

In modern capital markets, shareholders may behave more like share traders than like shareholders while their interest in monitoring these firms (for the long term) is minimal, if not lacking all together. Therefore, the EU correctly pointed to the **importance of stimulating shareholder engagement and putting more emphasis on the long-term viability of the firm**. ecoDa wholeheartedly supports the EU focusing more on the duties of shareholders in this respect.

However in widely dispersed shareholding models, this ambition will only get a good chance of realisation if a set of **complementary conditions** are further developed. It is also important to look into the issue of 'acting in concert' and further reflect on possible options of rewarding shareholders for their loyalty. Moreover the compatibility of the business model of modern capital markets with the emphasis on more stability in shareholding needs further investigation (*see ecoDa reaction to EU GP on CG in listed companies and to EU consultation on LT financing*)[4].

3- <u>Improve European competitiveness and growth by focusing more on the international level playing field</u>

The ambition to create a European market is a great one, which we all support. But at the same time, we should realise that governance and corporate law have been embedded for ages in the specific history, socio-economic context and political priorities, which are drastically different from one Member State to another. ecoDa therefore pleads for **better recognizing the diversity throughout Europe** and building on it rather than feeling hampered by it.

The EU has a particular role to play in addressing cross-border governance and company law issues, particularly those that facilitate the functioning of the single market. It is better placed than national governments to promote policy development in this area. Consequently, this should be

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"ecoDa's Response to the EBA Consultation on assessing the suitability of members of the management body and key function holders of a credit institution", July 2012, http://ecoda.org/index.php?id=134

[4] "ecoDa's response to the EU Green Paper on Corporate Governance for listed companies", June 2011, http://ecoda.org/uploads/media/PP_-_2011_06_29_CG_for_listed_companies.pdf and "ecoDa's response to the EU Green Paper on long-term financing of the European economy", May 2013, http://ecoda.org/uploads/media/PP_-_2013_05_15_GP_Long-term_Financing.pdf

an area of policy priority for the EU (rather than other areas which may encroach on the functioning of distinctive national corporate governance models).

The route forward could be combining a **harmonisation of the basic governance principles** (putting more emphasis on a principles-based approach, except when rules are necessary in specific fields) with **'mutual recognition'** of their application methods, rather than opting for a full harmonisation of detailed rules[5] (*see also ecoDa's response to the European Commission's Green Paper on corporate governance in financial institutions and remuneration policies)*[6]. Nevertheless, the overall objective in the long term remains to upgrade the efficiency of corporate governance in Europe, whatever the governance models to achieve this objective.

European competitiveness was hurt the last couple of years and certain countries have suffered from severe economic recession. Therefore, **ecoDa wants to promote that the EU critically evaluates its regulatory approach towards governance, especially when it comes to listed companies, the focus of their attention up till now**. Such companies do not operate on an isle protected from competition (by unlisted companies in their home market, as well as any other business at a global level). ecoDa would like to make a plea for rethinking the approach and this from different perspectives.

First of all, **a more stringent policy should be adopted on impact assessment**, critically analyzing not only new legislative proposals but also existing laws & regulations and if need be, calibrate to correct for unintended side-effects (*see ecoDa reaction EU GP LT financing and more recent EU papers*)[7]. It is recommended not to overshoot, because this makes listing less and less attractive, certainly for SMEs. Similarly, ex-post impact assessment of the efficiency of newly implemented regulations should be regularly undertaken within an appropriate time frame after their enforcement (ex-post impact assessment currently mainly exists for regulations that the European Commission wishes to amend). A greater use of the Regulatory Fitness and Performance Programme (REFIT) should be made.

A route for improving governance effectiveness is by **making better use of the principle of 'comply-or-explain'**, a principle fully backed and supported by ecoDa (*See Report of ecoDa's 2012 annual conference on "Comply or Explain: preserving governance flexibility with quality explanations"*)[8]. We plead for making the existing framework of regulation and self-regulation work more effectively by promoting a better implementation and higher quality explanations. To this end, ecoDa suggests the EU to further optimize the national expertise gained and develop

[5] Such proposal was already described in a 2002 publication: Lutgart Van den Berghe, 'Corporate Governance in a Globalising World: Converge or Divergence? A European Perspective', Kluwer Academic Publishers, 2002.

[6] "ecoDa's response to the European Commission's Green Paper on corporate governance in financial institutions and remuneration policies", July 2010, http://ecoda.org/uploads/media/PP_-_2010_07_GP_CG_Financial_Instit-Remu_01.pdf

[7] "ecoDa's response to the EU Green Paper on long-term financing of the European economy", May 2013, http://ecoda.org/uploads/media/PP_-_2013_05_15_GP_Long-term_Financing.pdf

[8] Report of ecoDa's 2012 annual conference on "Comply or Explain: preserving governance flexibility with quality explanations", March 2012, http://ecoda.org/uploads/media/REPORT_-_2012_12_AnnualConf-ecoDa-CoEreport.pdf

European guidance (on transparency as well as on clearly defining the role and duties of the board and the shareholders in monitoring good governance).

Having analysed with great interest the more recent EU proposals and Green Papers, ecoDa applauds that the EU organisations gradually agree with the **need for building more proportionality into the system** (*see e.g. ecoDa reaction to the UE GP on CG for listed companies and the ecoDa discussion with EBA as well as the more recent approach in some EU proposals/consultation papers*)[9]. Indeed, the capital markets are rather heterogeneous across Member States and even within each Member State substantial differences exist between the top-tier companies and the mid- and small caps.

4- The economy is more than listed companies

A last set of remarks have to do with the spectrum of companies covered up till now by the EU organisations. As already pointed out before, attention has mainly, if not solely, been put on listed companies. This is defendable, if one wants to create a European capital market. However by focusing solely on this type of companies, we not only ignore important other segments of the European economy, but on top of that, and even worse, the danger exists that the level playing field Europe is aiming at will be (is) drastically disturbed by creating a much higher regulatory burden for listed companies.

ecoDa is not pleading for increasing the regulatory burden for all other sectors of the economy, on the contrary, but would like to point to a couple of specific challenges for the promotion of growth and sustainability in all European Member states.

As to **unlisted companies**, stimulating good governance remains a priority but the **approach should be different than for listed companies** (even if the basics remain the same). For these companies the first hurdle to take is convincing the owners of the need for good governance structures and practices. Rather than investing in compliance with regulatory obligations, those companies are interested in what really brings added value to their firm. Here the arguments are clear: governance for unlisted companies could be more promoted as a leverage towards sustainable growth (e.g. better access to external financing) and long term success (e.g. succession issues) (see ecoDa reactions to EU GP on CG in listed companies and to EU consultation on long-term financing)[10.] Second, these companies are in need of professional guidance and coaching. Therefore ecoDa already developed its European recommendations for governance of unlisted companies, filling the void for numerous Member States who had no national governance codes for this important group of companies (*see Corporate Governance Guidance and Principles for*

[9] "ecoDa's response to the EU Green Paper on Corporate Governance for listed companies", June 2011, http://ecoda.org/uploads/media/PP_-_2011_06_29_CG_for_listed_companies.pdf and "ecoDa's Response to the EBA Consultation on assessing the suitability of members of the management body and key function holders of a credit institution", July 2012, http://ecoda.org/index.php?id=134

[10] "ecoDa's response to the EU Green Paper on Corporate Governance for listed companies", June 2011, http://ecoda.org/uploads/media/PP_-_2011_06_29_CG_for_listed_companies.pdf and "ecoDa's response to the EU Green Paper on long-term financing of the European economy", May 2013, http://ecoda.org/uploads/media/PP_-_2013_05_15_GP_Long-term_Financing.pdf

Unlisted Companies in Europe)[11]. Support from the EU is more than welcome to stimulate and promote good governance practices in unlisted companies.

A business sector that also deserves some special attention is the **governance within (multinational) groups of companies and the specific rights and duties of subsidiary boards** (and their directors). Except for some countries, a group-wide approach of governance is lacking completely. It is interesting to learn that the EU Action Plan has included this theme in its mid-term planning. ecoDa is looking forward with great interest towards the new developments in this direction.

Last but not least, ecoDa wants to draw the attention to the **lack of interest the EU organisations are showing, when it comes to public governance, especially the governance of State-owned enterprises and semi-public enterprises**. Although those companies also operate with public money, they have not been on the radar screen at EU level, this in great contrast with the OECD, who has devoted over the years large interest into developing recommendations and monitoring their application in practice. ecoDa therefore considers it necessary to draw the attention of the EU organisations to the sector of State-Owned enterprises, a sector that has exponentially grown throughout Europe, not in the least after the financial crisis. Professional governance of these companies, in line with (international) good governance principles, can bring a substantial leverage to economic growth and social welfare, as has been proven by some of the best practices in Europe. Numerous state-owned enterprises have already taken governance initiatives individually, that could be more widely supported and promoted as best practices.

The not for profit sector should also be taken into consideration, due to its increasing size and impact on sustainable development of European economies.

In addition to those elements, ecoDa recognises also that other topics will have an important impact on the European boards like:

- The Say on pay (which should be addressed in the upcoming shareholders' directive),
- CSR and non-financial reporting (already addressed in the draft Directive amending the Accounting Directives (Fourth and Seventh Accounting Directives on Annual and Consolidated Accounts, 78/660/EEC and 83/349/EEC, respectively)

[11] "ecoDa's Corporate Governance Guidance and Principles for Unlisted Companies in Europe", January 2010, http://ecoda.org/uploads/media/GUIDANCE_-_2010_CG_for_Unlisted_-_EU.pdf

ANNEX: More about ecoDa:

- ✓ As a representative body, ecoDa intends not only to react to the European initiatives taken in the field of CG but also to be proactive on specific items that ecoDa considers important for the improvement of Corporate Governance in Europe.

  - *ecoDa has defined its 2014/2015 pro-active year theme as the effective director (which includes sub-topics like: Professional selection process, Director development: education, induction, permanent development, behavioural rules, director evaluation).*

- ✓ As a confederation, ecoDa relies on its members to get access to the national developments on Corporate Governance in Europe and to collect the best CG practices in Europe.

  - *ecoDa carries on comparative surveys on specific topics (e.g. Say on pay).*
  - *ecoDa also generates a dynamics among its members so that they can learn about the best services offered to the individual board members (Education programmes/ Mentoring programmes for directors, local branches to be closer to the directors, etc.).*

- ✓ As an influencing body, ecoDa wants to take part in the CG debate and organises various roundtables (*e.g. on CG for family businesses- 12 March 2014*) and events (*e.g. on board selection process- 29 April 2014*).

- ✓ As a service provider for its members, ecoDa has developed two days programme for directors in complement to the education programmes offered by its national members.

- ✓ As a legitimate interlocutor of the European institutions, ecoDa tries to enlarge its representativeness throughout Europe in attracting new national institutes of directors and in promoting the creation of those institutes where they don't exist.

- ✓ As the European voice of directors, ecoDa is involved in an international network of IoDs (GNDI) to get awareness of the CG trends outside Europe and to take common positions when needed.

  - *The GNDI is currently is about to facilitate cross-membership among its international members to promote internationalization of boardrooms.*

- ✓ As an open organisation, ecoDa has developed relationships with organisations like ICSA, ECIIA, IBE, AFECA, Ewob and different Corporate Associates.

  - *ecoDa will for instance pursue the reflection on ethics and CG in close cooperation with the Institute of Business Ethics (IBE).*

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