Financial Services User Group's (FSUG)

response

to the Green Paper on EU corporate governance framework COM(2011)164

20 July 2011

FSUG c/o European Commission
Internal Market and Services DG
SPA2 4/69, BE-1049 Brussels
markt-fsug@ec.europa.eu

FSUG response to
the Green Paper on EU corporate governance framework COM(2011)164

The concept of corporate governance itself implies the existence of a number of distinct interests that may be in conflict. It is of vital importance, recognising these conflicting interests, to set out a framework within which issues may be addressed. According to the official documents of the European Commission, COM(2003)284, recommendations 2004/913/EC and 2005/162/EC, the main objective of the corporate governance framework is to strengthen shareholders' rights and to protect employees, creditors and other parties associated with companies.

FSUG fully supports the idea that a broader concept of the stakeholders' approach of corporate governance should be adopted. In this context, the decisions made of each and every single company should comprise of shareholders, employees, creditors and other stakeholders. Furthermore, FSUG would argue, that the main objective of the firm in this context is the long-term survival, growth and stability.

Also, FSUG observes that this green paper is mostly focused on institutional shareholders. Individual shareholders are not mentioned anywhere. This is unfortunate, as individual shareholders are mostly long-term holders and often engaged ones. They have been marginalised in the last decades (coming from about 50 % of the equity markets to 10-15 % today). Recent EU financial policies have further marginalised individual shareholders and pushed them out of equity markets and into packaged products, especially investment funds, which have a much higher turnover rate, i.e. are invested in a much shorter term on average, ands therefore have little incentives to behave as engaged shareholders.

Lastly, this green paper fails to address the key obstacle to shareholder engagement: the very poor performance of the intermediaries chain which makes it very difficult and often very costly for small shareholders to exercise their voting rights and for issuers to know who their real ('beneficial').

Questions

General

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.

FSUG is of the opinion that, from a consumer perspective, a strong effective corporate governance regime within an economy will enhance the performance and add value to companies whilst protecting the consumer interests and creating an ethical basis for choosing products and services.

Corporate governance, as defined in the Green Paper, is relevant to all companies whatever their size. At the same time, corporate governance must be effective and workable in the context of a particular company. Additionally, it should not be over burdensome. One of the key conclusions of a *Study on Environment Related Regulatory Burdens for SMEs* is that the extent of "Administrative regulatory burdens are already

higher and more burdensome on SMEs per employee than on larger companies, because regulation is not directly proportional to the size of the company."[1]

Thus, it is unlikely, that legislation and codes will fit all. Size is a particular issue in terms appropriateness of regulation and it follows that EU corporate governance measures should take account of the size of listed companies. The inevitable problem is how and what appropriate definitions or thresholds are adopted.

It would be appropriate if the European Commission commissioned research to determine the appropriate criteria for differentiating between large and small listed companies taking account of any significant cultural characteristics of Member States. Additionally, it would be appropriate to consider how other regulatory bodies, if at all, have differentiated their corporate governance legislation and codes.

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?

One of the major characteristic that differentiates listed from unlisted companies, is that in the former group ownership is usually much more disperse than in the latter. Higher levels of disperse ownership raises the probability of higher agency costs of equity and managerial entrenchment situations. On the other hand, unlisted companies are usually more opaque that may lead to higher agency costs of debt, or higher levels of conflict of interests between shareholders and other stakeholders (due to this higher level of opaqueness). Thus, principles designed for unlisted companies should consider these differences between listed and unlisted firms.

Nevertheless, as stated in Q1, corporate governance as defined in the Green Paper, is relevant to all companies whatever their size. If appropriately designed a code of corporate governance should enhance performance and add value to such companies. Creditors are likely to offer better terms including which should be reflected in the cost of capital. Customers will also benefit from contracting with a company that has a good level of governance as there will be greater transparency and less risk. There should however, be different codes that are proportionate and fit the varying sizes and the different ownership structure of unlisted companies. FSUG considers it important to always ensure that high levels of corporate governance standards are introduced and maintained in unlisted companies that are publicly accountable, i.e. in case of state-owned companies, companies that use the capital markets for financing, i.e. by issuing bonds and those that trade in financial securities.

1 Boards of directors

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?

The key role of the board of directors is to direct/supervise the affairs of the company. Board members are fiduciaries, required to act in the best interest of the company. To ensure an open discussion within the board about the company development, potential

---

[1] See *Study on Environment Related Regulatory Burdens for SMEs*, Center for Strategy & Evaluation Services LLP, p. 7, http://ec.europa.eu/enterprise/newsroom/cf/_getdocument.cfm?doc_id=3527.

risks and current operations, FSUG considers it necessary that there is a sufficient independent element in relation to the executives, especially to the CEO, to avoid potential conflicts of interest and to prevent concentration of management powers in the hands of one person. As the chairperson has a crucial role within the board, FSUG believes that the chairman should not carry executive responsibilities. It is important to ensure the functions and duties of the chairperson of the board of directors are separated from those of the CEO who will be responsible for executive/operational decisions and day-to-day management. Such a division will allow the chairperson and non-executive directors to oversee aspects about governance, overall policy and strategic direction and represent the needs of the shareholders and other stakeholders (being the guardian of shareholders' interest), will improve accountability and will provide checks and balances in the board. To some extent such a division addresses the agency problems in these circumstances.

1.1 Board composition

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?

Several studies have shown that board diversity leads to better performance. Carter et al.[2], after controlling for size, industry, and other corporate governance measures, found significant positive relationships between the fraction of women or minorities on the board and firm value. They also find that the proportion of women and minorities on boards increases with firm size and board size but decreases as the number of insiders increases. In a most recent study[3], Carter et al. support the conclusion that board diversity has a positive effect on financial performance as measured by Tobin's q.

FSUG fully supports board diversity. Boards that do not represent the whole breadth of stakeholders of the company's business are not able to do their jobs as capably.

Non-executive members of boards of companies therefore should have a wide experience, appropriate qualifications, personal qualities, independence and come from diverse backgrounds that fit the needs of the company in question. To enable boards to recruit new directors from the widest possible pool of potential candidates FSUG believes that recruitment policies should be:

a) precise about the profile of directors and
b) transparent to shareholders of the company.

Companies should be required in their annual reports to list the name of the chairperson and non executive members with appropriate details of their backgrounds, especially

[2] *Corporate governance, board diversity, and firm value*, Financial Review, Vol. 38 No.1, pp. 33-53, Carter, D.A., Simkins, B.J., Simpson, W.G., 2003.

[3] *The Diversity of Corporate Board Committees and Financial Performance*, Carter, David A., D'Souza, Frank P., Simkins, Betty J. and Simpson, W. Gary, 1.3.2008, available at SSRN.

current and recent external (board and management) positions, gender, age, and date of joining the company and board.[4]

While all FSUG members agree with the principle of gender balance in companies' boards, a vast majority is in favour of a legally binding approach (imposing gender quota) which would be reviewed after a period.

The FSUG consider that non-binding measures are insufficient, which is highlighted by the fact that a number of Member States do not follow the recommendations on remuneration and directors' pay adopted by the Commission in 2009.

A major problem is the lack of transparency on management remuneration, particularly in disclosure on individual managers and on items like the characteristics of stock option plans, pensions, and golden parachutes. Although the requirements and practice vary greatly across member states, in general stronger rules on transparency are needed.[5]

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?

Yes, listed companies should be required to precisely disclose their diversity policy in each Annual Report in order to indicate to shareholders, employees, regulators and all other stakeholders that the company takes seriously the requirement to operate to best business practice with respect to diversity policies and recommendations.

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

A recent survey of Egon Zehnder International[6] finds that in July 2010, 12.2 % of board positions at the 340 largest companies in Europe were held by women. However, the overall figures mask clear differences at national level according to the survey. In countries such as Portugal and Italy, women still only account for 3.5 % and 5 % of directors in top companies, compared to 29 % in Sweden and Finland and 32 % in Norway. The threat of legal quotas has fostered activities e.g. in France, where 37 % of positions went to women in 2010, according to the Zehnder survey.[7] The survey relates this development to the fact that the "French diversity strategy has been debated by the government for the past 18 months and the proposed legislation has already cleared the first major hurdles, making the establishment of a quota highly likely". Nevertheless, women are still underrepresented in economic decision-making, as Viviane Reding Vice-President of the European Commission, EU Justice Commissioner, stated when presenting her Gender Equality Strategy in September 2010.

---

[4] While all FSUG members agree with the principle of gender balance in companies' boards, a vast majority is in favour of a legally binding approach (imposing gender quota) which would be reviewed after a period.

[5] A small minority of FGUG members consider that a binding regulation, e.g. via local law, should only be considered as 'second-best' option and prefers the non-binding approach by local corporate governance codes as it is more flexible and can easily be adapted to changing circumstances. They feel that to establish non-binding regulation as an efficient tool to develop corporate governance practices at Community level it has to be implemented in a reasonably consistent way throughout the Union.

[6] http://www.egonzehnder.com/global/thoughtleadership/hottopic/id/78402633/publication/id/17500251

[7] http://www.egonzehnder.com/global/thoughtleadership/hottopic/id/78402633/publication/id/17500251

Regulation should ensure that listed companies have a balance between genders. It would be necessary, therefore, to establish some criteria/threshold as in the case of, for example, Norway. The comparative appraisal of boards in Norway has been favourable as compared to a number of other EU Member States in terms of the contribution of women to those boards. The Green Paper also cites evidence of the importance of women's contribution to company boards.

With regard to gender balance, following the lead given by Norway in legislating for a requirement that 40 % of listed companies' directors must be women, France and Spain have enacted laws to boost the number of women on boards and there is active debate on the merits or otherwise of such action currently taking place in Ireland, UK, Italy, Germany and Netherlands and others. As well as informed discussion it also can be expected that the entrenched corporate cronyism that has built up over the years in some board rooms will resist and try to counter progressive diversity proposals.

1.2 Availability and time commitment

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?

FSUG supports the ICGN guidelines[8] which states that "All directors need to be able to allocate sufficient time to the board to perform their responsibilities effectively, including allowing some leeway for occasions when greater than usual time demands are made. They should assess on an ongoing basis if new activities may limit their ability to carry out their role at the company, and boards should make substantive disclosures regarding the results of these regular assessments." In our opinion, the number of mandates should be restricted in a coherent way throughout Europe to help to ensure that non-executive directors do make a positive contribution to the boards. There is much reported evidence that non-executive directors were the holders of numerous such directorships in companies which speculated in various financial and property development activities leading up to the crisis and we await the outcome of criminal prosecutions to learn the extent of culpability and the extent to which such multiple directorships contributed. Financial Regulators, for example in Ireland, are suggesting that there be clear limits on the number of directorships and also subject to appropriate fitness and probity that an individual may hold. We would favour a fixed number of appointments, say up to three. Whereby the crucial position of the chairperson should be counted twice and all mandates in non-group listed companies (national and international) should be taken into account.

Additionally, FSUG considers it important that listed companies should be required to fully disclose board members' other positions in the annual report, together with the record of each board members' attendance at board and committee meetings.

1.3 Board evaluation

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

---

[8] http://www.icgn.org/best-practice/

FSUG favours encouraging listed companies to conduct a regular board evaluation. Encouraging companies to use external experts, however, from our point of view will lead to increased cost and bureaucracy; therefore we would prefer to leave the decision on the formal procedure (internal/external) to the board itself to avoid creating a new and expensive field of activity for advisors. Additionally, FSUG favours a regular evaluation of at least every third year or – in case the term of office is longer (as e.g. in Austria and Germany) – at the beginning and at the end of the term of office.

FSUG considers it important, that stakeholders will be informed about the (general) outcome of the evaluation in the next annual report of the company as far as confidentiality obligations do not provide otherwise.

Yes, with a peer review. There should be a pool of peers set up in jurisdictions.

1.4 Directors remuneration

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?

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

Yes, transparency is critical to ensure independent roles of non-executive directors. In terms of executive directors it is important to disclose the nature of the remuneration schemes and policies so that stakeholders can assess if directors remuneration fits with the level of the performance of the firm. In this context it is important that the remuneration is disclosed individually and that the remuneration committee/the board design appropriate policies and schemes which should be approved by shareholders. Where bonuses are paid as part of a remuneration package there is a real danger that directors and management will concentrate on the generation of high levels of short-term profits to enlarge their bonuses sometimes to the detriment of the longer term viability of the company, its employees and consumer customers. FSUG supports approaches to profit sharing such as is found in the Swedish Handelsbanken (www.handelsbanken.se) banking group whereby certain amounts above average profits are shared with management and staff through the foundation mechanism 'Oktogonen' and must be retained by the recipient and cannot be accessed or utilised until the person retires from the bank. We believe that there is merit in this method – it ensures a long-term perspective can be taken by directors and employees both their own advantage and that of the bank and its shareholders.

To enhance transparency, FSUG furthermore recommends introducing disclosure standards at the EU level, comparable to the Summary Compensation Table, required by the SEC for US listed companies[9]. This Summary Compensation Table gives a one-page overview on all remuneration components executive directors have been awarded to during the three precedent fiscal years. This information is provided in a standardised and therefore comparable format.

[9] Form DEF14A of the SEC, see e.g. the Proxy Statement 2010 of Intel Inc. (http://www.intc.com/intelProxy2011/executive_compensation/summary/), which has been filed in accordance with the disclosure requirements of the SEC.

With regard to the question of shareholder approval, FSUG considers it important to distinguish between a vote on the remuneration policy and a vote on the remuneration report. A vote on the remuneration policy means voting on the basis of the future remuneration of executive directors. Here FSUG considers it sufficient that a regular approval, preferably in line with the duration of directors' contracts takes place, if no substantial changes have been made to the remuneration policy in the meantime.

Contrary to that, voting on the remuneration report in our opinion should take place annually, to ensure a retrospective approval of the presentation of the remuneration in the annual report as well as of the absolute amount paid in the precedent year.

Both approvals should be mandatory. FSUG furthermore is opposed to legal opting-out clauses as it is the case in Germany.[10]

1.5 Risk management

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?

The Board are in a position to assess the risk to the company and therefore they should therefore be responsible for actions to counter and address risks internally and externally to the company. It is important that through a report the company's risk policy is conveyed to shareholders. This is an important part of the principal – agent agenda. These should include relevant key societal risks which are of growing significance in sophisticated capitalist societies. It should also be remembered that the evidence in the finance literature is that Directors tend to be risk adverse vis-à-vis shareholders and therefore a report will be useful to shareholders to assess whether the company is being directed in the way they wish.

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?

Yes.

2 Shareholders

2.1 Lack of appropriate shareholder engagement

We do not agree with the European Commission statement about 'shareholders' lack of interest in corporate governance'. The European Commission must distinguish between 'end-investors', shareholders as owners, and 'agency' like fund managers who are more asset managers than 'investors' or 'shareholders'. Moreover, the very significant hurdles shareholders are facing to vote (especially cross-border proxy voting) are not addressed.

---

[10] German regulator included an opting-out clause in para 286, clause 5 HGB, whereby companies can opt out from the legal requirement to individually disclose executive directors' remuneration in case the general meeting has approved a respective proposal with a three-quarter majority of voting rights present at the meeting. Experience in Germany shows that companies with a majority shareholder tend to make use of this opting-out clause which we do not consider as being good governance especially because the majority shareholder normally is present on the company's (supervisory) board and here receives this kind of information the other stakeholders do not obtain.

2.2 Short-termism of capital markets

Q13: 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.

Many recent EU policies and regulations are indeed favouring shareholders' short-termism:

- MiFID has further marginalised individual shareholders who are mostly long-term holders, by severely reducing the pre and post trade transparency for them, by fragmenting and making equity markets much more complex for the benefit of financial investors, especially professional traders and HFT. For a more detailed analysis, we refer to FSUG's reply to the MiFID review consultation.
- CRD and Solvency II regulations are penalising heavily equity holding by banks and insurers for their own account. These regulations – even before their full enforcement – are already pushing banks and even more importantly insurers (who have been a major long-term shareholder for their own account in Europe) out of the equity market. At the same time, and for the same reason, banks and insurers are also pushing retail investors further to 'packaged' products (savings accounts, investment funds in 'Units', etc.) to improve their capital ratios. These investment funds have on average a much higher turnover rate (close to 100 % for active equity funds) than portfolios of individuals investing directly on the equity markets and than insurers' portfolios investing for their own account. Also these regulations do not prevent banks from dealing with other businesses than lending and makes it easy for them to push retail investors out of capital markets and into much more short-term 'packaged' products.

In summary, MiFID, CRD and Solvency II are penalising long-term shareholders in several ways and are favouring short-term ones.

- The lack of EU wide collective redress provisions (despite EC reports having identified the issue) is favouring the lack of confidence of small shareholders: as soon as a problem occurs with an issuer, they know in most EU countries that they are very unlikely to get indemnified in case of an issuer's misbehaviour. So, they prefer to sell immediately rather then hold on these shareholdings.
- The KIID for UCITS (the principle of which could be extended to other investment products through the 'PRIPs' project) requires a maximum of 10 years track record for equity funds. But the time horizon of pension investors is much longer than that. Indeed, the EU regulations do not generally address the short-termism of packaged investment products, especially equity funds.
- Also, quite a few national tax regulations favour short-term investments versus long-term ones.

There are also other different reasons for short-termism for example political situations or investors' behaviour. Specifically, there are studies that suggest an important influence is executive compensation[11]. Excessive remuneration for short-term

[11] *Executive Compensation and Short-Termist Behaviour in Speculative Markets*, Review of Economic Studies (2006)73, Bolton, Scheinkman, Xiong, 2006, pp. 577-610.

performance leads to the short time horizon of managers. There could be also some kind of tax or capital incentives for long-run investors.

Finally the European Commission could evaluate whether certain kinds of tax or capital incentives are suitable to foster long-term investing.

2.3 The agency relationship between institutional investors and asset managers

Q14: 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?

Remuneration practices have been an important issue and key problem of inappropriate sales practices of investment consultants, insurance intermediaries and branch office staff of banks and insurance companies. The financial crisis brought to light that consumers have purchased a significant amount of financial services products which proved not to be suitable to consumers in terms of their expectations and risk-awareness. In particular, there is evidence that risky investment and insurance products were recommended to consumers because of high sales commissions from which conflicts of interest arise for sales persons not to recommend/sell products in the best interest of consumers.

Many problems have been recently reported: EFI (EuroInvestors – European Federation of Investors) in its position paper of February 2011 on MiFiD, with reference to the European Investors Working Group (EIWG) report of February 2010, *Restoring Investor confidence in European Capital Markets*: "Recent developments in financial markets have highlighted how the sale of financial products to retail consumers has been influenced by unbalanced fee structures and compensation mechanisms. In some cases, such compensation mechanisms compromise the ability of investment advisors to uphold the primacy of customers' interests."

Financial intermediaries will be stimulated not only on the basis of cash incentives, but do act on basis of non-cash incentives, too. Intermediaries and sales force may be motivated by a broad range of instruments (e.g. through positive incentives like travels, but also through incentives to keep the rate of complaints low).

A currently released study by European Commission on retail investment advice in the EU Member States showed that the rate of disclosure referring to inducements is rather poor. About only 5 % of the intermediaries/advisers gave mystery shoppers information on inducements.

Corporate governance is part of an asset manager's fiduciary duty to enhance the value of clients' assets and ensure the management are running the company in the long-term interest of shareholders. To being able to have an effective oversight of incentive structures, end investors must be provided with utmost transparency to understand if fee and remuneration structures are appropriate so that they can have full confidence that the costs they are suffering generate value for them. Therefore, prompt and full disclosure of the asset managers' remuneration scheme is needed.

FSUG positively notes the steps taken by the institutional investors' industry which is currently working on model contract terms between asset owners and their fund managers[12] with the aim of promoting more long-term behaviour in the capital markets and a greater focus on key risks. However, we favour an at least EU-wide standard to ensure a certain level of transparency regarding incentive structures and performance evaluation of asset managers.

Q15: 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?

Asset managers should have a duty to exercise their best diligence in the interests of their clients (and not only their institutional clients as the EC question warrants). The economic interests of asset managers are still not aligned to the ones of long-term holders (individuals and pension funds). In particular, we have no evidence in Europe of any fund manager having participated to any collective actions against issuers in Member States where it is allowed. This is very worrying, and is further evidence for the insufficient alignment of interests between asset managers and their long-term clients.

Also long-term end-investors ('beneficial owners') are weakly organised, and they have little leverage on their asset management providers:

- Individual ones for lack of resources and the failure of the European Commission to meet its 2009 commitment to propose a direct funding of retail investor representatives.[13]
- Also, to our knowledge long-term institutional end-investors (pension funds in particular) do not seem to have a representative organisation at European level.[14]

2.4 Other possible obstacles to engagement by institutional investors

Q16: 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?

The UK Stewardship Code[15] has shown that acceptance of a local code is high among institutional investors and has helped to improve standards of corporate governance. FSUG therefore favours the implementation of an EU Recommendation to invite local standard setters introducing non-binding codes for asset managers by ensuring indispensable minimum standards.

[12] http://www.icgn.org/best-practice/best-practice-consultations/

[13] European Commission Communication on *Driving European recovery*, Annex I, 4.3.2009.

[14] The EFRP (European Federation for Retirement Provision) membership does not match the institutional end-investors universe: pay-as-you go pension schemes, and fund managers are members, and insurers for their own account are not.

[15] http://www.frc.org.uk/images/uploaded/documents/UK%20Stewardship%20Code%20July%2020103.pdf

Q17: What would be the best way for the EU to facilitate shareholder cooperation?

The 2008 financial crisis has revealed deficiencies in corporate governance and a lack of shareholder engagement. Despite the adoption of the European Shareholders Rights Directive of 2007, there are still many obstacles facing individual investors in exercising their voting rights, especially cross-border. To further promote shareholders using their voice in European companies, FSUG promotes the establishment of a cross-border voting platform like EuroVote established by Euroshareholders/Euroinvestors and saluted by the European Commission.[16] Such a platform will increase individual investors' active participation in general meetings, especially cross-border. Complemented by a forum for private investors where they could exchange their views on certain companies, such a platform would enhance (private) shareholder cooperation significantly.

Furthermore, FSUG supports the creation of a uniform EU Proxy Form for the representation at general meetings so that all shareholders will have the chance to exchange their views before the general meeting and even afterwards.

2.5 Proxy advisors

Q18: 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?

Yes. Proxy advisors assist clients in meeting their fiduciary obligations as owners.

Their vote recommendations have proven to have a significant impact on the voting behaviour of institutional investors and, consequently, on the outcome at general meetings, especially cross-border. Therefore, as already proposed by the UK Stewardship Code, FSUG sees a need for the European Commission to set standards with regard to transparency of proxy advisors to ensure that they are conducting their business in a transparent, responsible and constructive manner. As a minimum, proxy advisors should be required to disclose the following information, available to all interested parties on the advisors' websites:

- Voting Guidelines
- Policy on Conflicts of Interest
- Stewardship Policy
- Monitoring Policy
- Disclosure of Voting Activity (post-season regular review).

FSUG considers that an EU-wide Code of Conduct should be introduced as a first step to ensure the necessary transparency. As experience of the UK Stewardship Code has shown, all major proxy advisors like ISS, Glass Lewis, ECGS etc. have committed themselves to this non-binding transparency standard.

[16] http://www.euroshareholders.org/eurovote

Q19: 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?

Providing consulting services to companies on which proxy advisory services are provided creates a severe conflict of interest for proxy advisors. FSUG therefore considers it important, as stated in our response to Q18, that this issue is addressed by an EU Code of Conduct. Such a Code of Conduct should include recommendations with regard to proxy advisors refraining to provide consulting services to companies.

Additionally, proxy advisors should be recommended to disclose any potential conflict of interests in the proxy voting report on the respective company.

2.6 Shareholder identification

Q20: 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? Please provide details (e.g. objective(s) pursued, preferred instrument, frequency, level of detail and cost allocation).

Any mechanism helping issuer to identify their shareholders would only enhance transparency towards the issuer. FSUG does not see any benefit for investors as long as issuers are not obliged to disclose the information they receive via any intermediary-guided mechanism also to all other shareholders. Experience in Germany, for example, has shown that more and more issuers change the form of their shares from bearer to registered shares in order to better know their shareholders. Some companies even link the entry in the share register to the shareholders' right to vote.[17] The information provided to other shareholders, however, has not increased in Germany in recent years.

2.7 Minority shareholder protection

Q21: Do you think that minority shareholders need additional rights to represent their interests effectively in companies with controlling or dominant shareholders?

Corporate governance is applied differently among European countries. The well-known study of LaPorta et al.[18], although quite old, describes these differences in a very clear way and provides a solid foundation upon which several studies on corporate governance are based. The case of minority shareholder is also affected by this variety of implementation levels. For example, Kim et al.[19] examine the relation between minority shareholder protection laws, ownership concentration, and board independence

[17] See e.g. Munich Re AG, Article 6(3) of the company's Articles of Association 2011 (http://www.munichre.com/app_pages/www/@res/pdf/ir/satzung_en.pdf?072010): "If shareholders are entered under their own name as being the holders of shares which belong to a third party and exceed 0.1 % of the share capital as stated in the Articles of Association, they shall be obliged pursuant to Article 3 para 4 item b of these Articles of Association to make disclosure regarding the submitted shares to the Company no later than three days prior to the General Meeting."

[18] *Law and finance*, Journal of Political Economy 106, LaPorta R., Lopez-de-Silanes, F., Shleifer, A., and R. Vishny, 1998, pp. 1113-1155.

[19] *Large shareholders, board independence, and minority shareholders' rights: Evidence from Europe*, Journal of Coporarate Finance 13, Kim K., Kitsabunnarat-Chatjuthamard P. and J. Nofsinger, 2007, pp. 859-880.

using a sample of large firms from 14 European countries and find that countries with strong minority shareholder laws have more independent directors and that when a country's minority shareholder rights are strong, then minority shareholders have the legal power to affect board composition. Thus, it is not so much of a matter of additional rights rather of a harmonisation of different regulations in Member States, with a direction of fostering minority shareholders' rights, taking account the specificities of each Member State.

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

Yes. FSUG considers it important to protect minority shareholders against related party transactions. This aim could be reached either by requiring issuers to provide a dependency report[20] together with the annual report on all transactions undertaken with the major shareholder(s) during the last fiscal year. This report should be audited in the same manner as the annual report. It should be ensured, however, that minority shareholders are informed about the outcome of the auditor's findings and the significant parts of the dependency report.

Another important measure would be the EU-wide introduction of legal proceedings in case shareholders are 'squeezed-out' of a company. Here, we point to the German example of the so-called 'Spruchverfahren': A shareholder holding at least 95 % of the share capital of a company can demand a squeeze-out of minority shareholders by paying them a cash compensation based on the value of the company at the date of the general meeting, the minimum compensation being the share's average stock exchange price during the past three months. Such a squeeze-out is subject to shareholder approval at a general meeting. However, as due to the ownership structure, the approval will always be passed with the votes of the majority shareholder, the adequacy of the cash compensation may be challenged in special proceedings (the 'Spruchverfahren') within three months after the publication of the entry of the transfer resolution in the commercial register. During the legal proceedings, a Common Representative ensures representation of all shareholders not directly participating in the 'Spruchverfahren'. The court decision has effect for and against all shareholders, including those who are not directly participating in the proceedings themselves.

Last but not least FSUG considers it important that in case of a majority shareholder exceeds a certain threshold the company should be obliged to appoint minority shareholder representatives to the board of directors.

2.8 Employee share ownership

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

The recent economic crisis has encouraged many institutions and companies to re-examine the role and purpose of corporate governance. Employee financial participation (EFP) provides a natural route towards a model where labour and capital are more closely linked. Shareholding encourages long-term employee interest in the company's progress and performance.

[20] Comparable to the Dependency Report required by German HGB

Employee share ownership can lead to employee participation in the corporate decision-making processes. This can only lead to increased scrutiny of company policies by those who have a vested interest in avoiding excessive risk taking.

EFP can also provide a model for business succession using an Employee Benefit Trust or similar vehicle.

Despite these clear benefits EFP remains at the fringe in all but a handful of the member states. With further encouragement it could play a much larger role in social, economic and industrial policy.

A number of measures could be adopted to encourage increased participation including more focused financial education and targeted tax measures.

If employee share ownership is to be encouraged, then the first objective must be to increase awareness and the availability of relevant financial education for employees especially those who work in hard to reach smaller businesses. An example of educational initiatives can be found in the work of the UK think-tank, the ESOP Centre.

For many participants in employee share schemes the financial value of shares received through plans can be a life-changing sum. However, those at the lower end cannot afford financial advice on how best to invest their gains.

Employees face a large risk in both holding a large amount of shares in and being employed by the same company. Financial services providers could do more to provide advice on how to diversify properly to employee shareholders.

Indeed, increasingly as pensions fall away the savings based share plans, such as SAYE Sharesave in the UK, are seen as a way to supplement pensions. Facilitating a transfer of assets from a share plan into a pension plan, preferably using a tax-neutral method, would encourage many more people to take up offers of EFP in their company.

There are measures already in place in France for decades, which have resulted in a large development of employee share ownership. FSUG believes the development of employee share ownership is positive provided that:

- Employee shareholders rights are not limited or sometimes even confiscated by issuers (there are many cases where the supervisory board of the employee shareholder fund includes the issuer's representatives, who decide on how the fund will vote at the issuer's AGM).
- Employees' holdings in shares of the company they work for remain a limited percentage of their savings in order to diversify their risks, as their salary is already subject to the same company's failure risk. We refer to the Enron case in the US or the Vivendi one in France where the DC schemes where much too heavily invested in company shares.

3 The 'Comply or explain' framework – Monitoring and implementing corporate governance

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?

FSUG supports the 'Comply or explain' framework in the context that certain minimum standards should be set by legislation leaving room for companies to adapt to certain corporate governance codes. These 'minimum standards' case is a matter of a debate; however, legislation is in many cases inflexible and the 'Comply or explain' framework offers the opportunity to adapt and change more easily and quickly. However, there is evidence that not enough detail or useful information is emerging from this process. ICSA reports that boards of directors were playing safe and preferring to stay with what lawyers recommended they should say rather than giving an open picture of the situation[21]. This conclusion shows that monitoring corporate governance should be further strengthened through this framework. Thus, companies departing from recommendations of corporate governance codes should indeed 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?

In the context of the answer given in the question above, 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. Their role should be to foster the sound implementation of the 'Comply or explain' framework, where the main objective should be to ensure a high level of transparency.

[21] *The Importance of Comply or Explain in the EU Business Environment*, ICSA. Feedback to the European Commission from the ICSA Corporate Governance Summit held in Brussels in October 2008.