



ASIA – EU CORPORATE GOVERNANCE DIALOGUE
TOKYO, FRIDAY, JULY 6, 2012

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EU HARMONIZATION OF CORPORATE GOVERNANCE:

WHAT HAS IT ACHIEVED?



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EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

II. A Survey of Major Initiatives

Pre-Crisis measures (1)

- European Action Plan: Modernizing Company Law and **Enhancing Corporate Governance** in the European Union - A Plan to Move Forward (2003);
- Directive on **Takeover Bids** (2004);
- Commission Recommendation Fostering an Appropriate Regime for the **Remuneration of Directors** of Listed Companies (2004);
- Directive on the Harmonization of **Transparency of Information about Issuers** Whose Securities are Admitted to Trading on a Regulated Market (2004);



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

II. A Survey of Major Initiatives

Pre-Crisis measures (2)

- Commission Recommendation on the Role of **Non-Executive or Supervisory Directors** of Listed Companies (...) (2005);
- **Audit Directive** (2006);
- Directive on the Exercise of Certain **Rights of Shareholders** in Listed Companies (2007);
- Commission Recommendation on the Regime for the **Remuneration of Directors** of Listed Companies (2009).



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II. A Survey of Major Initiatives

Post-Crisis measures (1)

- Green Paper “Corporate Governance in **Financial Institutions** and Remuneration Policies (2010);
- Green Paper “**Audit Policy**: Lessons from the Crisis” (2010);
- Green Paper “The EU **Corporate Governance** Framework” (2011);
- Proposal for a Directive on the **Access to the Activity of Credit Institutions** and the Prudential Supervision of Credit Institutions and Investment Firms (2011);



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II. A Survey of Major Initiatives

Post-Crisis measures (2)

- Proposal for a Regulation on **Insider Dealing and Market Manipulation** (Market Abuse) (2011).



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

III. Three General Observations

- **Broad and vague concept of corporate governance**
- **No clear line between corporate governance and company law**
(what about creditors and labor?)
- **We are standing on the eve of a major revision**



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

IV. Core Subjects of Harmonization

1. Management and Directors (1)

EU reinforced the presence and role of independent non-executive directors of listed companies by recommending Member State legislatures to implement (2005):

- **a balance of executive and non-executive directors**
- **a duty to create committees on nomination, remuneration and audit**
- **mandatory diversity of knowledge, judgment and experience on the board**



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

IV. Core Subjects of Harmonization

1. Management and Directors (2)

EU introduced the Principles of “comply-or-explain” (2006):

- companies must disclose corporate governance statement
- key information about the corporate governance practices
- statement must indicate whether company applies provisions on corporate governance other than those provided for in national law



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

IV. Core Subjects of Harmonization

1. Management and Directors (3)

In 2010-11 EU considers:

- **diversity on the board (gender, profession, nationality)**
- **limitation of the number of mandates of non-executive directors**
- **board duty to approve and take responsibility for the company's 'risk appetite'**



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

IV. Core Subjects of Harmonization

2. Executive Compensation (1)

EU repeatedly recommends Member States to balance mismatch between performance and executive directors' remuneration (2004, 2005, 2009) by requiring:

- **disclosure of remuneration policy and the individual remuneration of executive and non-executive directors**
- **a shareholders' vote on the remuneration statement**
- **an independent functioning remuneration committee**



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IV. Core Subjects of Harmonization

2. Executive Compensation (2)

Since a number of Member States have not adequately addressed these issues, Commission considers more mandatory approach (2011):

- mandatory disclosure of remuneration policy and the individual remuneration
- annual remuneration report on how the remuneration policy was implemented
- mandatory shareholder vote on remuneration policy



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

IV. Core Subjects of Harmonization

3. Shareholders' Rights and Responsibilities (1)

Based on the assumption that shareholders in listed companies need to be able to effectively exercise their rights throughout the entire European Union, the Commission implemented (2007):

- **a number of minimum requirements to facilitate the exercise of shareholders' rights at general meetings**
- **rules regarding modern forms of shareholder representation like proxy voting and electronic technologies**



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

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3. Shareholders' Rights and Responsibilities (2)

Commission intends to enhance shareholders' involvement on corporate governance issues (2011) by:

- implementing shareholder identification
- rules on proxy advisors, the protection of minority shareholders against abuse by a controlling shareholder and employee share ownership
- proper measures against shareholders' short-termism



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

IV. Core Subjects of Harmonization

4. SMEs and Non-listed Companies

Currently no differentiation between large-small and listed-unlisted companies. Commission considers to introduce such differentiations (2011).

Caveats:

- **No simple transfer**
- **In the light of existing national differentiation EU action is questionable**
- **“Comply-or-explain” does not work for unlisted companies**



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IV. Core Subjects of Harmonization

5. Auditing (1)

In reaction to accounting-fraud scandals the EU implemented (2006):

- **duties of statutory auditors and certain ethical principles to ensure their objectivity and independence**
- **a requirement for external quality assurance**
- **public oversight over the audit profession and improved co-operation between regulatory authorities within the European Union**



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IV. Core Subjects of Harmonization

5. Auditing (2)

Drawing lessons from the financial crisis the Commission is considering (2010):

- to improve the auditors' communication to stakeholders and regulators on what work they have carried out and what they have 'discovered' during their audit
- proper steps to eliminate possible conflicts of interest resulting from rendering auditing and consulting services to the same company



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

IV. Core Subjects of Harmonization

6. Credit Institutions

Commission has proposed detailed principles and standards applicable to corporate governance arrangements and mechanisms within credit institutions (2011) regarding:

- **the composition of boards**
- **the functioning of boards and their role in risk oversight and strategy**
- **the status and the independence of the risk management function**
- **the role of supervisors in monitoring risk governance arrangements of credit institutions**



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

V. Relevant EU Corporate Governance Policies

1. Institutions: From top-down Harmonization to Consultative Discussion

- High Level Group of Company Law Experts (2001-2)
- European Corporate Governance Forum (2003-11)
- Corporate Governance Advisory Group (2005)
- Green Paper Consultation Process (2010-11)



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

V. Relevant EU Corporate Governance Policies

2. Level: EU Entrenched between International and National Corporate Governance Standards (1)

- OECD, Basel Accord
- Global Investors (e.g. CalPers, TIAA-CREF)
- Member State Corporate Governance Codes



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

V. Relevant EU Corporate Governance Policies

2. Level: EU Entrenched between International and National Corporate Governance Standards (2)

Is EU action necessary at all?

- No need for a European Corporate Governance Code
- However: European Union sees an active role to play in corporate governance, because some specific rules and principles need to be agreed and coordinated at European level in Directives or Recommendations



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

V. Relevant EU Corporate Governance Policies

3. Instruments: Combining Mandatory and Self-Regulation

- **Hard law: EU directives and regulations**
- **Soft law: EU recommendations and national corporate governance codes**
- **EU: Growing tendency to change soft into hard law**
- **Current approach: self-regulation with permanent scrutiny by the Commission and revision at its discretion by selected mandatory rules**



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

V. Relevant EU Corporate Governance Policies

4. Formal Competence: From Promotion of the Internal Market to Crisis Management – and back? (1)

- **Most of the initiatives have been based on the fundamental freedoms of the European Treaty, in particular the freedom of establishment and the free movement of capital**
- **In 2009 the Commission stated: "The crisis highlighted that effective checks and balances within companies did not work".**



EU HARMONIZATION OF CORPORATE GOVERNANCE: WHAT HAS IT ACHIEVED?

V. Relevant EU Corporate Governance Policies

4. Formal Competence: From Promotion of the Internal Market to Crisis Management – and back? (2)

Three problems linked to the crisis-management rationale:

- **Global financial crisis does not discharge the Commission from duty to legitimize any harmonization initiatives**
- **No sufficient empirical basis for the contention that corporate governance has played an important role for the crisis**
- **Scandal driven harmonization tends to be shortsighted and lacks a sound long-term concept**



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VI. Conclusion

- **EU is still in search of a responsible role in the promotion of good corporate governance.**
- **An account of what European corporate governance harmonization has achieved up to the present is difficult to give, since major steps are currently under consideration of the Commission.**