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# SURVEY OF PRINCIPLES, GUIDELINES AND RULES IN THE FIELD OF CORPORATE GOVERNANCE IN EUROPE, WITH A FOCUS ON THE STRUCTURE AND OPERATIONS OF CREDIT INSTITUTIONS

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# SURVEY OF PRINCIPLES, GUIDELINES AND RULES IN THE FIELD OF CORPORATE GOVERNANCE IN EUROPE, WITH A PARTICULAR FOCUS ON THE STRUCTURE AND OPERATIONS OF CREDIT INSTITUTIONS[1]

## Introduction

The main objective of this paper is to discuss the current trends in corporate governance towards harmonisation in a European context,[2] taking into particular account the role played by those credit and financial institutions which fall under the scope of the EU/2000/12 banking directive concerning the taking up and pursuit of the business of credit institutions.[3]

Corporate governance, in a nutshell, concerns the "system by which companies are directed and controlled".[4] It refers to the formation and management of joint stock companies, company law provisions on capital, regulation by law and statutes of manager/shareholders relations, procedures for the appointment of supervisory boards, definitions of the responsibilities of managers, board members, auditors, etc. This definition encompasses the standard for decision-making, the duties of board members, and best practice. It is about setting optimal framework conditions for efficient entrepreneurial decisions.

Taking into account the fact that corporate governance is becoming an important issue in all industrial economies, the topic should neither be considered in isolation within any one country, nor focusing only on the consolidated experience in common law systems. As trade barriers fall, markets expand, information flows improve, and restrictions on investments disappear, it will become progressively easier

[1] Prepared by Dr. Chryssa Papathanassiou and Alessandra Chirico, Financial Law Division. The authors would like to thank Thomas Ordeberg for his assistance.

[2] See, *inter alia*, S. Grundmann and P. O. Mülbert, *Corporate Governance: European Perspectives*, in International and Comparative Corporate Law Journal, Vol. 2, Issue 4, 2001, 415 – 422; E. Wymeersch, *Factors and Trends of Change in Company Law*, Ibidem, 481 – 501; L. Renneboog, *Corporate Governance Systems. The Role of Ownership, External Finance and Regulation*, CEPS Working Document No 133, 1999.

They all take into account the emerging need to focus and concentrate particularly on the European perspective, especially because hitherto it has been discussed only randomly, as a consequence of the prevalence of the Anglo-American regulation of the capital market law. Nevertheless, the need of harmonisation and the consequent issue of adopting a European perspective on corporate governance has been on the political agenda at least since the EC Commission published its action plan of 11 May 1999, for the realisation of a financial market framework. In this document, the Commission identified the differences between national laws concerning the institutional structure of companies as a potential legal and factual obstacle to an emerging European financial market. See EU Commission, *Implementation of the Capital Market Frame: Program for Action,* Announcement of 11 May 1999, KOM (1999) 232 final.

[3] Directive of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, O. J. L 126, 26 May 2000, p. 1 – 59.

[4] This is a definition given by the Cadbury Committee in its final report *The Financial Aspects of Corporate Governance* in December 1992. It includes a dualistic approach: an internal, "directed", and an external, "controlled". The former consists of the management of the company and the external of the control exercised by shareholders, creditors and market. See also O. Williamson, *Corporate Governance*, 93 Yale L.J., 1197 (1984).

for investors of one country to invest in corporations in another.[5] Movement towards a world-wide capital market could in turn have a substantial impact on corporate governance in individual countries. In a world with intense competition for global savings, sophisticated investors will be attracted to jurisdictions in which investment structures serve shareholders' interests. Since the "attractiveness"[6] of a particular area will depend on its system of corporate governance, local norms may be adjusted to make domestic markets more accommodating to global trends.[7]

Banks are a critical component in a market economy because they provide financing for commercial enterprises, basic financial services to broad segment of the population and access to payment systems. Banks are in the forefront of market and technological developments, which pose new challenges for a sound internal management. In addition, some banks are expected to make credit and liquidity available in difficult market conditions. It is of decisive importance therefore that banks have strong corporate governance.[8] In addition, banks may play a role in corporate governance as **institutional investors** [9] given that the predominance of mutual fund management companies often belongs to banking groups. The increasing importance of institutional investors as holders of assets also means that their impact on the functioning of financial markets is steadily growing. This situation determines an overlapping discipline of different phenomena, as banks can own shares in other financial institutions, in subsidiaries and fund of different kind, in non-financial companies, and, to a certain extent, also in foreign companies. So banks can, in addition to the influence they have in their capacity as lenders, have influence in their capacity as shareholders or management bodies. As a final remark it has to be recalled that banks have a privileged access to strategic information regarding their clients; they are in general much better informed

[5] It should be noted that the European securities market has been partially fuelled by a liberalisation of cross-border activities by securities firms. The Investment Services Directive (93/22/EEC Directive) authorised all European Union securities firms to conduct cross-border operations anywhere in the EU based only on the license issued by their home state. Thus, well-capitalised firms of one country licensed to do business in their home country can now enter the European market and add liquidity.

[6] A key to understand the meaning of this expression is given by the theory according to which the corporation and its securities are products in financial markets to as great extent as "the sewing machines or other things the firm makes". Just as the founders of a firm have incentives to make the kind of sewing machines people want to buy, they have incentives to create the kind of firm, governance structure, and securities the customers in capital markets want. See, on this point, L.A. Bebchuk and M. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 Stan. L. Rev. 127 (1999).

[7] See B. R. Cheffins, *Current Trends in Corporate Governance: Going from London to Milan via Toronto*, 10 Duke J. Comp. & Int'l L. 5, 1999, p. 1 – 30. For further background on the increasing convergence of Corporate Governance, as a result of the far-reaching globalisation and deregulation of financial markets, see M. Balling, E. Hennessy and R. O'Brien (eds.), *Corporate Governence, Financial Markets and Global Convergence*, Kluwer Academic Publishers 1998; J. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implication*, 93 Nw. U.L.Rev. 641 (1999).

[8] On this point it is worth recalling a paper issued by the Basel Committee on Banking Supervision that provides guidance on corporate governance in banks. This paper forms part of an ongoing effort by the Committee to strengthen procedures for risk management and disclosure in banks. See *Enhancing corporate governance in banking organisations*, http://www.bis.org/publ/bcbs56.htm, where the need that banks are properly managed is clearly underlined, as most of the funds that credit institutions use to conduct their business belong to their creditors, in particular to their depositors. Furthermore, linked to this is the fact that the failure of a bank affects not only its own stakeholders, but may have a systemic impact on the stability of other banks.

[9] As a first reference, see the work edited by the OECD, *Institutional Investors in the New Financial Landscape*, 1998. On the subject in general, see G. Stapledon, *Institutional Shareholders and Corporate Governance*, Clarendon Press, Oxford, 1996.

about the financial conditions of corporate clients than most of the other investors, who own shares in the client companies.

## 1. Some preliminary remarks on the basic issue of separation of Ownership and Control as operating in Europe.

The essential feature of corporate governance (characterising the relationship among shareholders, the management and the board of directors) is given by the separation of ownership and control, as argued by Berle and Means,[10] in the sense that, although *de iure* legal systems used to treat shareholders as a company's owners, *de facto* investors in public corporations usually did not act in the manner one would expect of an owner. Instead shareholders allowed management to deal with matters of great importance. It should be further noted that giving executives the freedom to run a widely held public company (according to the model in common law systems) in many respects a sensible division of labour, as managers end up to be the effective corporate decision-makers, while shareholders cannot properly substitute for them. In such a context one of the major risks is given by the possibility of mismanagement.[11]

In fact, delegating decision-making to an inner circle of company executives gives birth to a tricky situation. As corporate executives receive only a tiny fraction of returns derived from the profit-enhancing activities they engage in on behalf of shareholders, they may be tempted to use their control over corporate assets to further their own interests at the expense of those who own equity. To the extent that managers pursue their own agenda, they impose what economists refer to as "agency costs" on these investors.[12]

Although various market instruments (like hostile take-over bids) can serve to deter self-serving managerial conduct in widely held companies, they do not entirely eliminate agency cost problems. Instead, those managing widely held corporations retain some scope to pursue their own agenda at the expense of the shareholders.[13]

[10] A. Berle and G. Means, *The Modern Corporation and Private Property,* (1932), New York, Harcourt, Brace & World, Inc., 1968.

[11] In the United Kingdom, for instance, fears that top executives lead a privileged existence and a scope to act in a misguided manner have helped to bring the topic of corporate governance to prominence in recent years. The process began with a spate of unexpected company failures and financial scandals in the early 1990s, with the most spectacular example involving the collapse of the business empire of Robert Maxwell in UK. Thus, concerns about low standards of corporate governance have led to much discussion about possible reforms.

[12] See Jensen-Meckling, *Theory of the Firm: Managerial; Behaviour, Agency Costs, and Ownership Structure*, in 3 Journ. Fin. Econ. 305 (1976); Fama, *Agency Problems and the Theory of the Firm*, in 88 Journ. Pol. Econ. 288 (1980). For an interesting investigation of this issue, see also A. Shleifer and R. W. Vishny, *A Survey of Corporate Governance*, 52 J. Fin. 737 – 754 (1997). The Authors develop the Agency Problem in terms of separation of management and finance, explaining the core principles of corporate governance as "the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment" through different strategies of control over managers.

[13] See A. Shleifer and R. W. Vishny, *op. cit.*

At any rate, it must be stressed that the results of this corporate governance research which is largely in nature based on common law systems, cannot be transposed unaltered into a Continental European context, since European countries' ownership structure and concentration are substantially different.[14]

From a legal point of view, the dichotomy between civil law legal systems (namely, albeit in a simplified manner, Europe) and common law legal environment (UK and USA) determines a remarkable difference, mirrored in the corporate structure, where two rival systems of corporate governance can be identified: a **dispersed ownership system** and a **concentrated ownership system.** On the one hand, the first is characterised by "strong securities markets, rigorous disclosure standards, and high market transparency, in which the market for corporate control constitutes the ultimate disciplinary mechanism"; on the other hand, the second system is characterised by "controlling blockholders, weak securities markets, and low disclosure and market transparency standards, with only a modest role played by the market for corporate control, but with a possibly substitutionary role played by large banks".[15] Under this assumption, recent commentaries have argued that deep and liquid securities markets appear to be an exception in civil law countries in which concentrated ownership dominates dispersed ownership, since these countries are mainly characterised by:

(i) the absence of adequate legal protections for minority shareholders;

(ii) the inability of dispersed shareholders to hold control or pay an equivalent control premium to that which a prospective controlling shareholder will pay;

(iii) the political vulnerability of dispersed shareholder ownership in left-leaning "social democracies".[16]

Moreover, focusing on the aspect of control, here defined not merely as "the discretion to dispose of the firm's capital, assets and customer relations in a way not expressly prohibited by existing legislation, regulations or contracts",[17] but as the **concentration of voting power**, some interesting observations can also be made.[18] For instance, low concentration of ownership and control is usually found in common law

[14] Recent scholarship on comparative corporate governance has been said to have produced "a puzzle" (John C. Coffee, Jr., *The Rise of Dispersed Ownership: the Role of Law in the Separation of Ownership and Control,* Columbia Law School, The Centre for Law and Economic Studies, Working Paper No 182, January 2001) While Berle and Means had assumed that all largely public corporations would mature to an end-stage capital structure characterised by the separation of ownership and control, the contemporary empirical evidence is to the contrary. Instead of convergence toward a single capital structure, the 20th century saw a polarisation of corporate structure between two systems of corporate governance: a dispersed ownership system and a concentrated ownership system.

For further analysis of this issue, see La Porta, Lopez-de-Silanos, Schleifer and Vishny, *Legal Determinants of External Finance*, 52 J. Fin., 1131, 1997.

[15] J. C. Coffee, Jr., *The Rise of Dispersed Ownership: the Role of Law in the Separation of Ownership and Control*, *op. cit.*, p. 2.

[16] For this "political thesis" according to which strong securities markets are inconsistent with the European political tradition of social democracy (where governments favour employees over shareholders and might even expropriate corporate assets if fuller transparency was required), see M. Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 Stan. L. Rev. 539 (2000).

[17] F. Barca, *Alternative models of control: efficiency, accessibility and market failures*, in J. Roemer (ed), *Property, relations, incentives and welfare,* St. Martin's Press Inc. and Macmillan Press, 1997.

[18] For further analysis of this point, see L. Renneboog, *op. cit.*, p. 5 – ff.

countries, where on average, a single shareholder does not hold more than 15%, and voting power is also dispersed as multiple class voting shares or voting restrictions are not common. When voting power is dispersed, free riding on monitoring might occur as a single shareholder bears all the costs of control but only benefits in direct proportion to his share stake. Consequently, management can end up in a powerful position. As a result, the key governance issues are: shareholders value, shareholders activism, stock options and performance related pay for management, accountability and independence of the board of directors, fiduciary duties of directors and hostile acquisition. Against the jeopardy of lack of control, pleads the fact that investors can pursue a short-term return-maximising portfolio strategy while the disciplining of underperformance is left to the market for corporate control where companies are continually auctioned.

The opposite case is high concentration of both ownership and control and can be found in a majority of the companies in Continental Europe and Japan, or in companies which have been taken over. In this case, large blocks or shares are held by few investors. It is clear that this structure almost precludes a hostile acquisitions market.

## 2. International dialogue

The 1990s saw a number of important developments in the field of international discussions on corporate governance. International organisations have thus devoted increasing attention to corporate governance as a topic of global concern.

In May 1999, the OECD published its “Principles of Corporate Governance” which it noted “are the first attempt to develop a set of international standards for corporate governance’ (OECD, 1999).[19] In June 1999 the OECD and the World Bank signed a memorandum on understanding that created a Global Corporate Governance Forum for the discussion and co-ordination of global standards of corporate governance. Other multilateral agencies, including the International Monetary Fund (IMF), the Asian Development Bank, and the Asian-Pacific Economic Co-operation organisation, as well as American and British institutional investors, are actively pursuing agendas to bring about reform of corporate governance systems around the world. As highlighted in the previous paragraphs, three main reasons to justify the increasing significance of corporate governance today could be identified:

(i) the globalisation of financial markets[20];

**(ii)** the proliferation of new financial products;

**(iii)** the rise of the institutional investors.

[19] OECD Principles of corporate governance, OECD, Paris, 1999.

[20] For evidence regarding a potential reverse development, see H. James, *The End of Globalization, Lessons from the Great Depression*, Harvard University Press, 2001, pp. 201.

In the Asian context, for instance, there have been references to the 1997 crisis as a starting point for the interest in corporate governance issues in that region, spurring, *inter alia*, reforms in the listing rules of stock exchanges in Malaysia.[21]

On the other hand, in a European context, deep and significant changes have occurred.

Despite the fact that continental stock markets have traditionally been thin and illiquid, several studies nowadays show that the number of firms listing on European stock exchange rose sharply at the end of the 1990's.[22] Although the pattern is far from being uniform, the equity market grew rapidly in the late 1990s in France, Germany and Spain. Elsewhere, the number of listed companies may have declined, possibly because of an international wave of mergers and acquisitions, which itself is a sign of convergence. Furthermore, while IPOs once mainly characterised the U.S. and the U.K. markets, they have become common practises across Europe.[23]

As a general observation, it might be argued that the surge of interest in corporate governance in the 1990s reflects, to some extent, a change in the way in which the role and functions of private companies in society are perceived towards a wider interpretation of what the purpose and goals of corporations are and should be. Corporate governance is indeed concerned with the institutions that influence how business corporations allocate resources and returns. More specifically, "a system of corporate governance shapes who makes investments decisions in corporations, what type of investments they make, and how returns from investment are distributed".[24] In most economies, corporate enterprises play a critical role in shaping economic outcomes through the decisions that they make about investments, employment, trade, and income distribution. Much of the contemporary debate on corporate governance has focused on the merits of different national systems for generating favourable outcomes for corporations themselves and the regional and national economies in which they are based.[25] As a result, the maximising of profits of private corporations is recognised as one of, or even the only, relevant goals

[21] It may prove recalling the remarks made by Jesus Estanislao, President and CEO of the Institute of Corporate Directors in the Philippines and former Finance Minister in the early 1990s, which underline how weak corporate governance structures have undermined the ability of East Asian economies to establish sound and sustaining economic growth. See *East Asia's Financial Meltdown: Why Corporate Governance Matters*, http://www.cipe.org/efn/estanislao.php3

[22] See Van der Elst, *The Equity Markets, Ownership Structures and Control: Towards an International Harmonisation?*, Working Paper, Financial Law Institute, Ghent University, Belgium, April 2000 as quoted by John C. Coffee, Jr., *The Rise of Dispersed Ownership: the Role of Law in the Separation of Ownership and Control, op. cit.*, p. 17.

[23] As John C. Coffee, Jr. points out: "the significance of this point bears emphasis, because systems of concentrated ownership were thought to lack the institutions necessary to bring new companies directly into the equity market" (Id. p. 19).

This new trends operating in Europe are further strengthened by some other changes that are currently underway in the markets including (1) the inexorable movement towards a pan-European stock exchange; (2) the increased activity of securities analysts with regard to European corporations with minority public ownership; (3) the accelerating convergence in international accounting standards, and (4) the current international wave of mergers and acquisitions (Id. p. 92).

[24] O' Sullivan, *Contests for Corporate Control: Corporate Governance and Economic Performance in the United States and Germany*, Oxford University Press, 2000.

[25] See M. Roe, *Some Differences in Corporate Structure in Germany, Japan, and the United States*, 102 Yale L.J. 1927 (1993); Id., *Political Preconditions to Separating Ownership from Corporate Control*, 53 Stan. L. Rev. 539 (2000), where the influence exerted by social democracies on managers to stabilise employment or to forego some profit-maximising risks with the firms is particularly emphasised.

for such entities by a number of those recommendations and statements of principle that are discussed in the below.

## 3. The context in which rules and principles on corporate governance are drafted

In international *fora* on corporate governance, increased attention has been paid to pressures on national systems of corporate governance to converge towards common standards that are allegedly being generated by the process of globalisation, commonly understood as the development of commodity markets to permit the free flow of economic resources from one use to another across national economic borders.[26] Taking into account this process, the new emerging phenomenon dealing with this "juridification of globalisation" could be easily interpreted as a result of the absence of a supranational recognised authority,[27] which leaves the floor to the development and strengthening of forms of self-regulation as an expression of the so-called "private sector main responsibility".[28]

All the documents regarding rules and principles of corporate governance in such an international/global context do not constitute binding law more than insofar that they have been adopted by national legislators and integrated into the applicable national laws.[29]

The OECD principles (see section 4 *infra*) is a case in point, stating, as they do in the preamble, that the principles laid down therein are non-binding. The principles are not substitute for the law: they represent supplementary principles and standards of behaviour and good practise. According to the preamble, in fact, the principles are not meant to be used in national legislation but rather as points of reference in the different areas of corporate governance covered by the principles. As will be seen in the below, however, the recent developments in the field of corporate governance guidelines have also implied that

[26] It is worth specifying that there are several approaches to explain the use of the term "globalisation". For the purposes of this paper, it is worth recalling what is meant by "globalisation" in finance, and by the sources of value-added in the internationally-competitive financial services sector. It normally refers to origination, trading and distribution of debt and equity capital market instruments and their derivatives, foreign exchange trading and securities brokerage, management of market risk and credit risk, loan syndication and structured bank financing, corporate finance and advisory services, and asset management. All these activities are considered in terms of a "value-chain", one that ultimately gives rise to the real economic gains attributable to financial-centre operations.

[27] Of particular significance for the present purposes are: M. Shapiro, *The Globalisation of Law*, (1993) 1 Indiana Journal of Global Legal Studies, 37 – 64; G. Teubner (ed), *Global Law Without a State*, Dartmouth, 1997; F. Snyder, *Governing Economic Globalisation: Global Legal Pluralism and European Law*, European Law Journal, Vol. 5, No 4, 1999, 334 – 374.

[28] See P. Hommelhoff, *The OECD Principles on Corporate Governance: Opportunities and Risks from the Perspective of the German Corporate Governance Movement*, in International and Comparative Corporate Law Journal, Vol. 2, 4, 2001, 457 – 480, where the principle of the private sector's main responsibility is defined as the most significant OECD's philosophy. The Author analyses the relationship between the public authority (the legislature) and the private sector in elaborating a regulatory framework and in drafting codes of best practise in corporate governance's matters, with the intention to stimulate investor confidence on a global scale.

[29] This is the so-called "recognition procedure" aimed at reconciling "private standard-setting with the regulator's unchanged responsibility for the legal issues entrusted to it" (Hommelhoff, *op. cit.,* 463). What really matters here is that through the recognition procedures private rules are transformed into statutes without changing their meaning, but by means of a process of hardening the soft law.

organisations active in the international financial markets have begun to use such guidelines as one of the benchmarks for evaluating potential investment opportunities.[30] Moreover, as a matter of fact, the OECD principles have been recognised as “the only multilaterally endorsed and comprehensive code that governments of countries are committed to promoting”.[31]

In particular, for the sake of completeness of such a scenario, it has to be said that corporate governance codes - instruments still in the search for the most appropriate forms of management and supervision - are also the products of the efforts to regulate in a better way the conduct of companies the securities of which are traded on the markets. The bodies that have drafted these codes or recommendation have often contained a strong component of market regulators, for which these codes constitute an instrument for marketing the services they offer to the investing public.[32]

## 4. The OECD Principles of Corporate Governance[33]

In consideration of the broad impact of the OECD principles, as shown in the previous section, they seem to merit a section of their own where the contents of the provisions and the comments/amendments suggested by various actors are elaborated upon at some length.

The express purpose of the OECD principles is to assist governments in their efforts “to evaluate and improve the legal, institutional and regulatory framework for corporate governance in their respective countries”.[34] Furthermore, the principles are intended to provide guidance and suggestions for stock exchanges, investors, corporations and other parties that are deemed to have a role in the development of good corporate governance. The principles focus on publicly traded companies, but the preamble states that they might to some extent also be useful for improving corporate governance in non-traded companies such as privately held or state-owned enterprises. It might be of interest to note that the OECD principles make no attempt at defining what should be the objective of the corporation’s activities.

[30] OECD Counsellors for the Economy in Corporate Governance Matters, *Corporate Governance Improvements of the Competitiveness and the Obtaining of Capital in Global Markets*, Paris, 1998.

[31] Communication from the OECD, WT/WGT/W/93 of 31 October 2000.

[32] See E. Wymeersch, *Factors and Trends of Change in Company Law*, in International and Comparative Corporate Law Journal, Vol. 2, 4, 2001, 481 – 501.

33 The OECD Council, meeting at Ministerial level on 27-28 April 1998, called upon the OECD to develop, in conjunction with national governments, other relevant international organisations and the private sector, a set of corporate governance standards and guidelines. In order to fulfil this objective, the OECD established the Ad-Hoc Task Force on Corporate Governance to develop a set a non-binding principles that embody the views of the Member States countries on this issue. Following extensive consultations with various bodies, the OECD principles were presented to the OECD Council, meeting at Ministerial level on 26-27 May 1999, where they were formally adopted.

It should be recalled that there are five main headings under which the OECD Principles of Corporate Governance are organised. They are: (I) The rights of shareholders; (II) The equitable treatment of shareholders; (III) The role of stakeholders in corporate governance; (IV) Disclosure and transparency; (V) The responsibilities of the board.

34 See, OECD Principles of Corporate Governance, cit., “Preamble”.

It is asserted in the preamble to the Guidelines that they are not meant to be used as a substitute for private sector initiatives to develop in more detail what constitutes “best practice” in governance.

The focus of the principles set out is on the problems that may arise as a result of the separation between ownership and control.

As regards the legal or quasi-legal status of the principles, as stated in the preamble they are non-binding and do not aim at detailed prescriptions for national legislation but rather should be used as a starting or reference point for policy makers when they examine and develop their legal and regulatory framework in the field of corporate governance.

The OECD principles have been commented upon by the International Corporate Governance Network (ICGN), and in so doing the ICGN proposes a number of amendments to the OECD principles. These amendments are suggested with the express purpose of providing “clear, concrete guidance” on how to implement the OECD principles in practise.

The recommendations set out by the ICGN are in the form of a “working kit” that aims to articulate the tenets of corporate governance as viewed by ICGN members. At the same time, these amendments affirm certain principles that were suggested in the OECD principles, such as the “one-share, one-vote” principle with regard to shareholder voting rights. While this principle was mentioned in the OECD principles, it was explicitly affirmed therein that no position was taken on the applicability of this concept. In this respect, the OECD principles are more prudent than the recommendations issued by other organisations active in the field of corporate governance. Not only in the ICGN amendments, but also in the pan-European principles and recommendations issued by the European Association of Securities Dealers (EASD), the principle of “one-share, one-vote” is recognised and upheld.[35] Further amplifications set out by the ICGN include an opinion on the composition of board committees, where the ICGN amendments suggest that certain committees (notably those that concern themselves with audit, nomination and remuneration questions) should be composed wholly or predominantly of independent non-executives.

## 5. Organisations active in the field of international corporate governance

A number of other organisations (i.e. the WTO, the IMF, the OECD, the International Corporate Governance Network, the European Corporate Governance Network, the World Bank and their

[35] The EASD’s principles favour “one-share, one-vote” because it provides all shareholders with a greater incentive to participate in the decision-making process, furthering more closely the interests of the company as a whole: to wit “one-share, one-vote” principle is strongly endorsed by institutional investors who wish to have voting rights proportional to the cash-flow rights they acquire.

Ombudsman)[36] elaborated rules of international corporate governance. For the sake of clarity, with regard to the EU legislative projects, it should be noted that the harmonisation of company law structures in the EU, as in the case of easing cross-border mergers and level take-over bid procedures, has been blocked for some time, and according to recent analysis, no immediate breakthrough is expected, apart from the recent adoption of the legislation for the European Company Statute.[37]

It should be noted that the European Bank of Reconstruction and Development (EBRD) has adopted a checklist on the implementation of principles of corporate governance. The checklist takes into account the OECD guidelines (see section 5 *infra*) and uses them as a starting point for a comprehensive evaluation of the state of corporate governance rules in the institutions to be assessed in their roles as potential investees. Depending on whether the institution is considered to be subject to good or satisfactory principles of corporate governance, or whether the rules in place are considered to be lacking or inappropriate, the risk associated with the project may be adjusted accordingly. In cases where the risk arising from this factor is deemed to be high, this may be a substantial factor when determining whether to proceed with the equity investment. Thus, this would be an example of how non-binding rules (in this case a modified version of the OECD guidelines) can be applied in an international context and directly influence decision-making by actors in the financial field. For the EBRD, corporate governance is a field where prospective members of the EU have made a lot of progress in the past ten years. However, progress in this area is perceived as a dynamic process as new markets are created and new technologies are used, which make changes in existing corporate governance necessary. Minority rights and sound public bid procedures are according to the EBRD some of the priorities. It is acknowledged that progressive strengthening of corporate governance in one bank is likely to demonstrate effect on other banks.

It is also suggested in the introductory part of the checklist that it might form part of the EBRD's standard due diligence in assessing a project and the risk factors associated with it. This statement provides further confirmation that the corporate governance regime of an institution is a factor that may substantially influence the evaluation of the prospects of a project. In this way, a connection between the corporate governance regime and the pecuniary value (as affected by considerations of risk) of a potential investee is firmly established.

[36] The above-mentioned organisations have compiled a thorough collection of full text corporate governance codes, principles of corporate governance and corporate governance reforms. It could be worth recalling, *inter alia*, the collections made available on the web-site by the World Bank (World Bank codes page in http://www.worldbank.org/html/fpd/privatesector/cg/codes.htm), by the OECD (http://www.oecd.org/oecd/pages/home/displaygeneral/0,3380,EN-home-76-3-no-no-no,FF.html) and by the European Corporate Governance Network (http://www.ecgn.ulb.ac.be/ecgn/codes.htm).

[37] See, on this point, K. Lannoo, *Corporate Governance, West and East: A Synthesis of the EU Framework in the Perspective of Enlargement*, in *Corporate Governance, Financial Markets and Global Convergence*, Kluwer Academic Publishers, 1997. The way for the European Company, known by its Latin name (Societas Europaea (SE), has been paved after the adoption on a regulation to establish the European Company Statute (ECS) and on the related directive concerning worker involvement in European companies were adopted by the Council of Ministers on October 8, 2001, thirty years after the first proposal. The legislation is due to enter into force in 2004.

The Financial Stability Forum (FSF) has elaborated twelve standards, which are widely accepted as good principles, practices or guidelines for sound financial systems. The Compendium of Standards provides a point of reference for financial authorities and market participants. Corporate governance features among the set of standards related to sound institutional and market infrastructure. The Compendium of Standards refers to the OECD principles of corporate governance.[38]

Another recent addition in this field is the corporate governance ratings service provided by Standard & Poor's, to be applied in emerging markets around the world. The ratings take into account such issues as transparency, recognition of minority shareholder rights, board effectiveness and the level of commitment to accountability and shareholder value. It may be noted that both the S&P corporate governance ratings and the guiding principles of the EBRD are mainly applicable to corporations in countries that have traditionally been viewed as less developed in the field of company law and financial regulations. Notwithstanding this state of affairs, the principles embraced by the various corporate governance guidelines might be of some interest in a European context as well, laying down as they do criteria that are considered to be minimum or desirable standards in different areas of company law.

Scoring systems similar to the S&P ratings have also been undertaken in Europe, for example by the German Association of Financial Analysts, Portfolio Managers and Investment Consultants that has developed a Scorecard for German Corporate Governance.[39]

## 6. National guidelines, recommendations and codes of good practice on corporate governance in the EU countries

Here is briefly sketched a comparative section, where the main points of relevant recommendations and codes of good practice in the 15 member states of the EU are described. Similarities and differences are then pinpointed and discussed, and summarily analysed in the light of the international framework of non-binding rules and statements of principle in the field of corporate governance.[40]

In most countries, the relevant documents are those issued by organisations or institutions such as the stock exchange, professional associations or shareholder organisations.[41] It should be noted in this context that many organisations active in the field of corporate governance discussions explicitly assert in their respective statements and guidelines that rules on corporate governance are not fit to lay down in laws,

[38] See http://www.fsforum.org/Standards/KeyStds.html.

[39] Another organisation active in the field of international corporate governance is the Californian pension fund, CalPers, who has inter alia adopted a number of global proxy voting principles. Moreover, one of the major American institutional investor, the Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) has also drafted a policy statement concerning principles of corporate guidance where individual issues are elaborated upon to some extent.

[40] Such a comparative analysis is of basic importance to appreciate the degree of convergence of different legal systems in Europe. For a more structured comparative overview of company law systems in EU, see E. Wymeersch, *Current Reform Initiatives: Challenges and Opportunities*, paper presented in Stockholm on 7-8 December 2000 at the conference on *Company Law Reform in OECD Countries. A Comparative Outlook of Current Trends.*

since the developments in the markets are too fast to allow for them to be accommodated in the statutory regulations on companies. However, such a statement is to be evaluated extremely carefully, as legal rules and the enforcement of the same (especially the ones related to the protection of the shareholders and creditors), have been gaining significant importance in explaining corporate governance of the European companies.

### 6.1 Basic tenets of corporate governance rules and principles in the EU countries

The national guidelines, regulations and principles in the field of corporate governance display a high degree of uniformity as regards the basic tenets of corporate governance. A number of general and broadly formulated principles seem to be shared by the European countries, and these principles could be taken to form a groundwork upon which the national corporate governance rules build and elaborate to a higher or lesser degree. These general principles include:

(i) The shareholders have a right to protection of basic rights such as the right to secure methods of ownership registration; to obtain relevant information on the corporation on a timely and regular basis; the right to participate and vote in general shareholders meetings in order to take decisions affecting the company and themselves as well as the right to elect and remove members of the board. Furthermore, the shareholders have a basic right to secure ownership and convey or transfer shares in a secure way (involving registration or notarial procedures when necessary). One basic shareholder right of central importance is also the right to share in the profit of the corporation.

(ii) The remuneration policies of the board and its relevant committee/s should be transparent and information should be provided with regard to the remuneration of the board and the considerations underlying the decision to set the existing level of remuneration.

(iii) A clear division of responsibilities should be maintained at the head of the company, between the board and the management.

(iv) The board should be chiefly responsible for monitoring managerial performance and achieving an adequate return for shareholders, while preventing conflicts of interests and balancing competing demands on the corporation.

(v) The board should contain some directors that do not perform management functions within the company or its subsidiaries (non-executive directors).

[41] A useful link for such a survey is: http://www.calpers-governance.org/principles/international/other.asp

(vi) The board should be able to exercise objective judgement on corporate affairs independent, in particular, from the management.

(vii) The national rules on corporate governance should ensure that relevant information on the structure and operations of the company is disclosed. Information that should be thus disclosed includes facts pertaining to the financial situation, performance, ownership structure and governance of the company.

(viii) The board should have meetings scheduled on a regular basis in order to be able to monitor continuously the management and operations of the company.

## 6.2 Short overview of national corporate governance regimes and recommendations issued in the EU countries

### 6.2.1 **AUSTRIA**

In the case of Austria, it seems that no organisation or institution has taken the initiative to draft any recommendations or principles on good corporate governance. However, some provisions in Austrian company law might be mentioned in this context, as they demonstrate the degree to which principles of corporate governance have been taken up by the legislator.

Under Austrian law, it is mandatory for stock corporations and large limited liability companies to maintain a supervisory board that monitors the actions of the management board. This supervisory board must contain a number of members who are elected by a council representing the employees: a third of the board members are appointed in this manner.

It is strictly forbidden to introduce multiple voting rights, even though a maximum number of votes per stockholder can be specified in the articles of association. The “one-share, one-vote” principle is widely adhered to.[42]

### 6.2.2 **BELGIUM**

In Belgium, the Commission on Corporate Governance seeks to promote improved standards of corporate governance within Belgian companies, chiefly with a view to enhancing their competitiveness on the capital markets. The Commission takes the view that the powers vested in the various bodies involved in corporate governance should be clearly defined and the rules on financial reporting should be strengthened. It has adopted a single set of recommendations for all listed companies.[43] In the preamble to

[42] See K. Gugler, S. Kalss, A. Stomper and J. Zechner, *The Separation of Ownership and Control in Austria*, in Barca and Becht (eds.), *The Control of Corporate Europe*, Oxford University Press, 2001.

[43] Federation of Belgian Enterprises (VBO/FEB), *Corporate Governance – Recommendation from the Federation of Belgian Enterprises*, 1998.

these recommendations, it is stated that it would be preferable not to resort to statutory provisions to enforce corporate governance in Belgium. Instead, the market authority of the Brussels Stock Exchange proposes a “comply or explain” approach with regard to listed companies.[44] This approach would entail an obligation on behalf of listed companies to disclose the specific circumstances or reasons explaining why the recommendations have not been complied with. As regards the substance of the principles laid down in the recommendations, it may be noted that they are more wide-ranging, with respect to a number of areas, than the principles set out in the OECD Guidelines. The recommendations include, *inter alia*, the rule that the board of directors should not consist of more than twelve members and that the board committee responsible for deciding on the remuneration of directors should be made up of a majority of non-executive directors.

With regard to the procedure of recognition,[45] the Commission considers that Belgian company law already incorporates the basic concepts required for adequate corporate governance. More specifically, the legislation embodies the principle “one share, one vote”, the rule that all directors share equal responsibilities, the requirement that directors act in the sole interest of the company and the rules on conflicts of interest within the board of directors.

### 6.2.3 DENMARK

A number of draft Guidelines on Good Management of a Listed Company have been issued by the Danish Shareholder’s Association in February 2000.[46] This short list of general principles is a summary and do not elaborate on corporate governance questions in any detail. Nevertheless, it is possible to deduce a few conclusions from the material at hand.

First of all, it can be observed that the guidelines express a wish that “shares with disproportional voting rights should be abandoned”: this would seem to be a call for adherence to the “one-share, one-vote” principle embraced in the Belgian and Greek recommendations as well. The guidelines suggest that the board should have at least 4 non-executive members (in the guidelines, the expression used is “4 members independent of day-to-day management”).

Furthermore, the guidelines contain a number of suggestions on other fields of governance as well and bring forth quite explicit recommendations in some fields that have not been covered by most national corporate governance guidelines. In particular, it is recommended that the dismissal compensation of a director should not exceed 2 years payment, and that the compensation in question should not be paid out if the director “severely mismanages his job, or if he/she resigns on his/her own initiative”. It is also stated that the dismissal compensation should not include “any kind of bonuses”. Such an explicit

[44] See *Belgium Report of the Commission on Corporate Governance* (Cardon Report), edited by the Brussels Stock Exchange in 1998.

[45] See *supra*, footnote 27.

[46] Guidelines on Good Management of a Listed Company (Corporate Governance), Danish Shareholders Association, http://www.shareholders.dk/index.asp

recommendation in this field has not been included in any of the other guidelines and recommendations, and the conditions for receiving compensation are also peculiar to the Danish guidelines. It may be suggested here that the inclusion of such recommendations in the guidelines reflect the more egalitarian wage structure of Denmark in comparison to other countries in the European Union.

### 6.2.4 FINLAND

In the case of Finland, it seems that no organisation or institution has taken the initiative to draft any recommendations, principles or codes of good practice on corporate governance.[47] However, some provisions in the Finnish Companies Act (734/1978, as amended) might be mentioned in this context, as they can show the degree to which principles of corporate governance have been taken up by the legislator.

What can be underlined is that the "one share – one vote" principle (stated in chapter 3, section 1 a, subsection 1 of the FCA) is deemed to be the starting point of shareholders' voting rights. Thus, each share shall carry one vote in all matters handled at the General Meeting of the Shareholders. The Article of Association may, however, stipulate that the shares shall carry different numbers of votes. The rationale behind this clause (allowing the existence of shares with multiple voting rights) is that each share shall carry at least one vote, therefore, different numbers of votes may be attached to the shares by a introducing different classes of shares in the Article of Association.[48]

### 6.2.5 FRANCE

In France, there have been a few reports and recommendations issued in the field of corporate governance. The Committee on Corporate Governance chaired by Marc Vienot has released two reports on corporate governance, in 1995 and 1999 (the Vienot I and II reports)[49] and the AFG-ASFFI Commission on Corporate Governance also issued, later in 1999, a set of recommendations on corporate governance for publicly traded companies. These reports focus on somewhat different topics, and it would seem that the AFG-ASFFI recommendations cover a wider array of subjects than the Vienot reports.

The AFG-ASFFI principles address, among other topics, the question of separation of the oversight and executive functions of the company and recommend that the positions of Chairman of the Board and Chief Executive Officer should be kept separate from each other. In this, the AFG-ASFFI provisions are

[47] Notwithstanding, in order to have a clear picture of the situation of corporate governance in Finland, it could be worth making a reference here to the *Rules of the Helsinki Stock Exchange* (http://www.hexgroup.com/regulation/englanti/contents.html), as they highlight the regulation of matters of great importance for shareholders and securities markets.

[48] For a more accurate analysis, see an unofficial translation by Edita Ltd, *The New Finnish Companies Act*, Edita Ltd, Helsinki 1997.

[49] Available at the following web-site: http://www.ecgn.ulb.ac.be/ecgn/docs/codes/vienot1-fr.pdf and http://www.ecgn.ulb.ac.be/ecgn/docs/codes/vienot2-en.pdf

quite similar to those that can be found in the Belgian recommendations (see section 6.2.2 *supra*). Another question discussed in the AFG-ASFFI recommendations is the number of directors on the board: the recommendations note that French law prescribes that there shall be at least three and no more than twenty-four directors on the board. The suggestion is then made by the AFG-ASFFI Commission that the number of directors should be kept at a "reasonable level" and that a limit of sixteen members should be imposed in practice.

The Vienot II report elaborates on some points that are not discussed in detail in the AFG-ASFFI recommendations such as the disclosure of remuneration awarded to management and directors. It may be interesting to observe in this context that the Vienot II report suggests that some remuneration amounts awarded to directors should be disclosed individually. This recommendation would seem to go further than the OECD guidelines in this respect and to be more in line with the suggested amendments to these guidelines issued by the ICGN, wherein it is stated that the remuneration amounts of individual directors should "preferably" be disclosed by the company.

As regards the presence of non-executive directors on the board, the Vienot II report is of the opinion that at least one-third of the board should be made up of such directors, while some committees should contain as large or larger a number of non-executives (non-executive directors should account for at least one-third of the audit and appointment committees, and the remuneration committee should contain a majority of such directors).

The final provisions of the Vienot II report concern implementation of the recommendations of the report. The considerations of the Committee on this point mirror those expressed in the Belgian guidelines: the Vienot II report states that it is necessary that listed corporations should comply with the recommendations set out in the two Vienot reports and explain any deviations from such compliance. In this, the Vienot recommendations follow the same lines as the Belgian and and Greek guidelines: the adoption of the "comply or explain" approach by various countries would seem to suggest that such an approach has gained some acceptance in the European Union member states.

### 6.2.6 GERMANY

The German Panel on Corporate Governance has issued a Code of Best Practice for Corporate Governance, in which frequent references are made to the OECD Guidelines. In the German Code, it is often noted that provisions of the OECD Guidelines are covered by the German company laws.[50] This is the case, according to the Code: (i) in the field of protection of shareholder's rights, through provisions in the German Act on Corporate Control and Transparency and the German Stock Corporation Act (*Aktiengesetz*), (ii) with regard to the equal treatment of shareholders, it is asserted without qualification that the principles stipulated by the OECD is in place for German companies and (iii) the disclosure and transparency rules in the OECD guidelines is, according to the Code, covered by provisions in a number

[50] See http://www.corgov.de/english/grundsaetze.shtml

of Acts (the German Stock Corporation Act, the German Securities Trading Act, the German Commercial Code, the German Antitrust Act and the German Banking Act).

### 6.2.7 **GREECE**

The Committee on Corporate Governance in Greece has adopted a series of principles on corporate governance.[51] These principles display a quite high degree of similarity with the recommendations of the Belgian Banking and Finance Commission, and as such are more far-reaching in their implications than the OECD Guidelines. It is asserted in introductory part of the recommendations that any direct introduction of statutory regulations raises the risk that compliance may be enforced to the letter rather than to the spirit of efficient governance: this statement echoes the almost identical assertion made by the Belgian Banking and Finance Commission in its set of recommendations for Belgian listed companies. Another point where the Greek recommendations display a high degree of similarity with the Belgian principles is in the suggestion made that a "comply or explain" approach should be adopted by the relevant authorities. Moreover, the Committee on Corporate Governance in Greece recognises the right to cast a vote for each share, regardless of class, as a basic shareholder right. In this adoption of the "one-share, one-vote" principle, the Greek recommendations once more bear witness to a strong similarity to the Belgian guidelines issued ten months before the Greek Commission released its set of recommendations.

### 6.2.8 **IRELAND**

The Irish Association of Investment Managers (IAIM) has issued a set of guidelines for corporate governance, share option and other incentive schemes.[52] These guidelines do not, thus, cover all the questions and areas discussed in the OECD guidelines and in many of the national recommendations, but centre on issues pertaining to the remuneration of management and the operation of option and/or incentive schemes for the employees. In this limited field, some interesting observations and conclusions can be drawn from the Irish guidelines. First of all, it is observed in these guidelines that the IAIM endorses the UK Combined Code on Corporate Governance in its entirety: in this context, the IAIM notes that the requirements regarding disclosure of director's remuneration have hitherto differed considerably between Ireland and the UK, and that the requirements set out in the UK Combined Code should be adopted in Ireland and that the Irish Stock Exchange should amend its Listing Rules to accommodate such a change. The Irish Stock Exchange also affirms that it has incorporated certain provisions of the Combined Code in the Listing Rules of the Exchange (June 2001).

[51] For a further analysis, see http://www.ismm.ru/corp/greece.htm. See also *Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation,* Committee on Corporate Governance in Greece (under the co-ordination of the Capital Market Commission) available at the following web-site: http://www.ecgn.ulb.ac.be/ecgn/docs/codes/greece-engl.pdf

[52] See http://www.ecgn.ulb.ac.be/ecgn/docs/codes/iaim.pdf

As regards specific procedures for the determination of remuneration, the IAIM guidelines assert that the remuneration of executive directors should be determined by a special remuneration committee, made up wholly of non-executive directors. In this, the guidelines display a high degree of similarity to those set out in the ICGN Statement on Global Corporate Governance Principles (see section 5 *supra*), wherein it is stated that the remuneration committee of the board should be made up "wholly or predominantly" by non-executive directors. The UK Combined Code is expressly invoked as the source of this proposal in an Irish context. The IAIM Guidelines also contain some provisions limiting the amount of remuneration, more specifically a rule that options granted to any director should not exceed 4 times his/her total annual emoluments from the companies involved in a share option scheme. This would seem to be a delimiting provision of the same kind as the Danish rule on maximum dismissal compensation, if considerably less extensive in its scope and application than the principle suggested by the Danish Shareholder's Association.

### 6.2.9 ITALY

The Committee on Corporate Governance in Italy has issued a report (the Code of Conduct)[53] in which a number of principles for companies are set out. These principles do not address questions of shareholder's rights or issues pertaining to the procedure at shareholder meetings, but focus instead on the roles and functions of management and the board of the company. It is recommended that a number of board members shall be non-executives, and the comments made in conjunction with the Code observes that non-executive directors normally outnumber executive directors in Italy. On a detailed level, the Code of Conduct recommends that the committee that is responsible for the appointment of directors should contain a majority of non-executive directors. The same composition is recommended for the remuneration committee. General remarks are also made with regard to the relation between the board and the management, in which context the Code repeats the basic principles that seem to be shared by the European Union countries (namely, that the board should exercise its functions independent from management).

It should be also recalled that, despite the applicability of these general principles, in February 1998 the Italian Government passed an Act reforming the Law on Financial Services,[54] stock exchanges and listed companies. With regard to listed companies, the reform was intended to strengthen minority shareholders' rights. The idea behind the new rules on corporate governance was that active institutional investors would make use of these rights in their monitoring of listed companies.[55] A reduction of the agency costs

[53] *Italian Report & Code of Conduct (Preda Code)* available at the following web-site: http://www.ecgn.ulb.ac.be/ecgn/docs/codes/CodeofConduct.pdf

[54] *Testo Unico delle leggi in materia di Intermediazione Finanziaria*, Legislative Decree 24 February 1998, No 58, http://www.ecgn.ulb.ac.be/ecgn/docs/codes/TestoUnico(eng).pdf

[55] On this point it is worth recalling the paper written by M. Bianchi e L. Enriques, *Corporate Governance in Italy After the 1998 Reform*: *What Role for Institutional Investors?,* in Quaderni di Finanza CONSOB, No 43- January 2001.

stemming from the separation between ownership and control in listed companies would follow, with beneficial effects for shareholders' wealth and for the national economy as a whole.

### 6.2.10 LUXEMBOURG

In Luxembourg, no set of corporate governance guidelines seems to have been issued, and thus the rules laid down in law are the main sources of legal material in this area. The relevant provisions are binding, as opposed to many of the statements issued by organisations in other countries, and are prudent in comparison with the recommendations issued by independent actors such as ICGN or Hermes Investment Management Limited. Rules are laid down on, e.g., the reporting requirements of listed companies: these rules set down requirements that do not appear to be overly restrictive (listed companies are required to issue annual and semi-annual report incorporating financial and other information of relevance to outside parties).

### 6.2.11 THE NETHERLANDS

A set of recommendation on corporate governance in the Netherlands was issued in 1997, the so-called Peters report.[56] This report contained forty recommendation made by the Dutch Committee on Corporate Governance. The report is not drafted in the form of provisions for the Stock Exchange (as is the case in Belgium and Ireland) but rather as a set of recommendation by an independent committee similar to the committees issuing guidelines in Germany and Greece. The points made in the Peters report are quite general in nature and do not delve into specific questions to any great extent. The document contains no discussion on such issues as the relation between ownership and shares and voting rights or the composition of the board and its committees, and is thus not as enlightening as many of the guidelines and recommendations issued in other EU countries.

### 6.2.12 PORTUGAL

In Portugal, the Commissâo do Mercado de Valores Mobiliàrios (the Securities Market Commission) has adopted a set of recommendations on corporate governance.[57] The principles stated in this document are quite general and noncommittal, consisting as they do mostly of broad guidelines and statements of intent. No detailed prescriptions are given with regard to such questions as voting principles, the compensation of board members or the relations between the board and the management. Those few practically applicable admonitions that are contained in the recommendations do not go very far in comparison to the guidelines that have been drafted in other EU countries. A general admonition to refrain form using so-

[56] *Peters Report & Recommendations* in http://www.ecgn.ulb.ac.be/ecgn/docs/codes/nl-petersreport.pdf

[57] *Recommendations on Corporate Governance,* Comissão do Mercado de Valores Mobiliários, http://www.ecgn.ulb.ac.be/ecgn/docs/codes/cvmv(eng).pdf

called “poison-pill” strategies is laid down, and it is recommended that special committees be set up within the board of directors to handle, *inter alia,* matters pertaining to the nomination and remuneration of directors. Another principle set out in the recommendations is that one or more members of the board should be independent in relation to the dominant shareholders. This practice is “encouraged” by the Securities Market Commission: the choice of this formulation, and the suggestion that “one or more” such members should be included, would seem to imply that this rule is far more limited in its scope than the recommendations drafted in Belgium, France or Ireland.

### 6.2.13 SPAIN

In Spain, the Comisi**ó**n Especial para el estudio de un C**ó**digo Etico de los Consejos de Administraci**ó**n de las Sociedades has adopted, in February 1998, a set of recommendations on corporate governance, know as Código de Buen Gobierno or (more appropriately) *El Gobierno de las Sociedades Cotizadas*.[58] Such a code of good practice is composed of three different parts focusing: (I) on the main political aims of the initiative within the framework of the Spanish regulatory reform; (II) on a detailed analysis of the role and functions of the Board of Directors, with a particular stress either on the relationship between the Board itself and the shareholders and on the rules of disclosure and transparency; and finally (III**)** on what is properly defined as *Código de Buen Gobierno***,** containing a set of broad guidelines on the rules of conducts of the different bodies involved in the corporation. One of the most important principle set out in such recommendations is that one or more members of the board should be independent in relation to the dominant shareholders.

What should be highlighted in the case of Spain is that the Commission taking care of the drafting of the Code is not expression of the private sector (as in all the other cases under analysis here), but instead it has been established following a proposal of the Minister of Economy.[59]

### 6.2.14 **SWEDEN**

In Sweden as in Denmark, the entity responsible for the drafting of a set of recommendations on corporate governance is the shareholder’s association. The guidelines issued by the Swedish shareholder’s association develop in some detail various areas in the field of corporate governance.[60]

It is interesting to note that the Swedish guidelines include a provision that is identical to the rule set out in the Danish corporate governance principles with regard to the dismissal compensation of a director.

[58] See *Código de Buen Gobierno,* http://www.ecgn.ulb.ac.be/ecgn/docs/codes/codgoes1.pdf

[59] It should be also recalled that all the members of the Commission have been appointed after a decision taken at the ministerial level on 24 March 1997. Such a practice is even strongly reflected in the establishment of another Commission acting in corporate governance matters, called Comision Nacional del Mercado de Valores (CNMV) - the agency in charge of supervising and inspecting the Spanish Stock Markets – which was created by the Securities Market Law (No 24/1998).

[60] Corporate Governance Policy, Swedish Shareholders' Association, http://www.ecgn.ulb.ac.be/ecgn/docs/codes/aktiespararna.pdf.

That is, the Swedish recommendations state that the managing director should not receive severance payment in excess of the equivalent of two years basic salary, and that no bonus should be paid out. Furthermore, in the recommendations it is suggested that no severance pay shall be awarded in the case where the managing director resigns of his/her own initiative or where he/she has seriously mismanaged the assignment.

The recommendations set out that a remuneration committee should be set up as a subgroup of the board, but no principles are suggested with regard to the precise composition of that committee. Furthermore, the recommendations do not contain any provisions on voting rights.

### 6.2.15 **UK**

In the UK, different initiatives that aim to draft rules and principles on corporate governance have resulted in a number of reports, statements and recommendations being issued. One document (the so-called Greenbury Recommendations)[61] deals exclusively with the question of remuneration for board members, and goes quite far in its recommendations on this matter. In this set of recommendations, it is suggested that the board should set up a special remuneration committee and that this committee should consist exclusively of non-executive directors. In advocating this make-up of the remuneration committee, the Greenbury Recommendations go further than most of the other collections on corporate governance principles adopted in other EU countries: insofar as the question has been addressed in other EU states, the recommendations have not gone further than suggesting that some or, in certain cases (Belgium, Greece), a majority of the members of the remuneration committee should be non-executive directors. The Greenbury recommendations also supports detailed reporting of the elements in individual remuneration packages, a demand which is also expressed in the ICGN amendments to the OECD Guidelines (see section 5 *supra*). The Greenbury Recommendations would also seem to be one of the first collections of guidelines where the "comply-or-explain" approach was laid down as a suitable vehicle for the achievement of an improved corporate governance regime.

A more recent (January 2001) set of guidelines on corporate governance is the Code of Good Practice issued by the Association of Unit Trusts and Investment Funds (AUTIF).[62] These guidelines in themselves are quite wide in scope and do not delve into details. The practical interest of the Code as such is rather limited in view of the broad and non-committal manner in which the recommendations are drafted, but the recommendations also include references to the Combined Code of the London Stock Exchange. This body of rules contains provisions that are more detailed, and they have a direct bearing on the behaviour of companies listed on the London Stock Exchange since the principles laid down in the Combined Code must be adhered to by all such companies. The procedure for ascertaining whether a company has complied with the Combined Code or not is outlined in the same Code, and it might be

[61] http://www.ecgn.ulb.ac.be/ecgn/docs/codes/greenbury.pdf

[62] http://www.investmentfunds.org.uk/closed/members/circulars/Green/002-01-01.pdf

interesting to note that a "comply-or-explain" approach has been adopted by the Stock Exchange Authorities in this case.

The Combined Code elaborates on the desirability of maintaining a division of functions within the bodies of the company, and states (in its provision A.2.1.) that a decision to combine the roles of chairman and chief executive should be publicly justified.

The Combined Code also recommends that a board should include a balance of executive and non-executive directors, even though no specific ratios or minimum numbers of non-executives are set down in the relevant provision. In some of its provisions, the Combined Code echoes the earlier recommendations issued: when the Code recommends that "levels of remuneration should be sufficient to attract and retain the directors needed to run the company successfully, but companies should avoid paying more than is necessary for this purpose", this wording corresponds in full to a principle set out in the Greenbury Recommendations. As regards the question of executive remuneration, however, the Combined Code does not go as far as the Greenbury Recommendations: the Combined Code merely recommends that a remuneration committee be set up, without elaborating on how such a committee should be organised.

Similar provisions relating to accountability and audit are included in the Combined Code: in this area, the Code states that a "sound system" of internal control should be maintained and that an annual review should be undertaken of risk management as well as financial, operational and compliance controls. Furthermore, it is recommended that an audit committee be established under the auspices of the board.

A recent compilation of principles and recommendations on corporate governance is the Statement on UK Corporate Governance and Voting Policy 2001, drafted by Hermes Investment Management Limited.[63] These principles address a number of issues pertaining to corporate governance, such as the composition of the board and its committees, the separation of roles at top level, the determination of the remuneration of board members and the information that should be included in the annual and periodical reports and statements.

The Hermes Statement asserts that separation of the roles of chairman and chief executive is highly desirable, and that deviations from this principle generally are not desirable.

## CONCLUSION

1. Corporate governance is a global language to encompass a set of different rules, ranging from minority shareholders rights to auction type bid procedures for public projects. Corporate governance is part of a bigger picture, pieces of which can be found in corporate law, administrative law, securities laws and supervisory rules.

[63] http://www.hermes.co.uk/corporat/PDFs/CorpGov.pdf

2. An ounce of prevention is worth a pound of cure, and IFIs have an important role to play in assisting countries to strengthen their corporate governance systems. The OECD principles constitute a recognised standard that other international organisations use in the framework of their projects. To the extent that international principles are “soft” law without any legal enforcement mechanisms, their application by private institutions and public bodies is fostered by monitoring from international organisations in their capacity as lenders. However, it should be noted that only structural changes have sustainable effects. The answer how to achieve sustainability can be twofold. On the one hand, national laws must be reinforced with provisions of sound corporate governance practices. On the other hand, national authorities and private companies need to be educated to monitor and apply sound rules of corporate governance.

3. In order to be effective, corporate governance can be complemented by the monitoring effect of a market for corporate control that disciplines managers and gives a price instantly to adverse managerial decisions and practices. In order to achieve a market for corporate control, measures that promote such a market, as the take-over directive, should be given priority at the EU level. Fostering such a market may lead to more transparency achieved via market mechanisms, while the role of state agencies could be reduced to a monitoring of large asymmetries, fraud, money laundering etc.

4. Ownership and control are separated in a corporation. To reduce the agency cost, the rights of minority shareholders are necessary so that they make informed decisions under equal treatment.

## Annex I : Comparative Table

| Country | National guidelines, recommendations and codes of good practice on corporate governance | Date |
|---|---|---|
| AUSTRIA | No organisation or institution has taken the initiative to draft any recommendations or principles on good corporate governance | |
| BELGIUM | **"Merged" Code**<br>Belgian Corporate Governance Commission (an imitative of the Brussels Stock Exchange) and the Commission Bancaire et Financière/Commissie voor het Bank- en Financiewezen<br>The "Merged Code" resulted from the :<br>**Cardon Report (1998) & Banking and Finance Commission Report (1998)**<br>**"Guidelines on Corporate Governance Reporting"**<br>Issued 18 November 1999 | December 1998 |
| DENMARK | **Guidelines on Good Management of a Listed Company (Corporate** | February 2000 |

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|---|---|---|
| | **Governance)**<br>Danish Shareholders Association | |
| FINLAND | No organisation or institution has taken the initiative to draft any recommendations or principles on good corporate governance | |
| FRANCE | **Vienot I Report**<br>Conseil National du Patronat Francais (CNPF) and Association Francaise des Entreprises Privees (AFEP) | July 1995 |
| | **Vienot II Report**<br>Mouvement des Entreprises de France (MEDEF) [formerly CNPF] and Association Francaise des Enterprises Privees (AFEP) | July 1999 |
| | **Recommendations on Corporate Governance**<br>AFG-ASFFI Commission on Corporate Governance | September 1999 |
| GERMANY | **Cromme Commission**<br>Commission charged to develop a German corporate governance Kodex, following the recommendations of the Baums Commission | Ongoing |
| | **Baums Commission Report**<br>(German title : Bericht der Regierungskommission Corporate Governance) | 10 July 2001 |
| | **Corporate Governance Rules for German Quoted Companies**<br>German Panel on Corporate Governance | January 2000 |
| | **German Code of Corporate Governance (GCCG)**<br>Berliner Initiativkreis | June 2000 |
| | Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG)<br>German Ministry of Justice | Ratified on 5 March 1998 |
| GREECE | **Principles on Corporate Governance in Greece: Recommendations for its Competitive Transformation**<br>Committee on Corporate Governance in Greece (under the co-ordination of the Capital Market Commission) | October 1999 |
| IRELAND | **Corporate Governance, Share Option and Other Incentive Schemes**<br>Irish Association of Investment Managers ("IAIM") | March 1999 |
| ITALY | **Report & Code of Conduct ("Preda Code")**<br>Committee for the Corporate Governance of Listed Companies | October 1999 |

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|---|---|---|
| | Source : Milan Stock Exchange<br>**Testo Unico sulle disponsizioni in materia di intermediazione finanziaria**<br>Law Reform based on Draghi Proposals | February 1998 |
| LUXEMBOURG | No organisation or institution has taken the initiative to draft any recommendations or principles on good corporate governance | |
| THE NETHERLANDS | **Peters Report & Recommendations** | June 1997 |
| PORTUGAL | **Recommendations on Corporate Governance**<br>Comissão do Mercado de Valores Mobiliários (CMVM) | November 1999 |
| SPAIN | **Código de Buen Gobierno** | February 1998 |
| SWEDEN | **Corporate Governance Policy**<br>Swedish Shareholders' Association | January 2000 |
| UK | **Cadbury Report**<br>**Greenbury Report**<br>**Hampel Report (Final)**<br>**The Combined Code**<br>Part of the London Stock Exchange Listing Requirements<br>**Internal Control : Guidance for Directors on the Combined Code**<br>(Turnbull Report)<br>Institute of Chartered Accountants in England and Wales<br>**The KPMG Review Internal Control: A Practical Guide**<br>**Code of Good Practice**<br>Association of Unit Trusts and Investment Funds ("AUTIF")<br>**Hermes Statement on Corporate Governance and Voting Policy** | December 1992<br>July 1995<br>January 1998<br>June 1998, 1999<br>January 2001<br>July 1998 |