101 A Comparative Study of Corporate Governance Across Borders

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Faculty Biographies

David R. Birk

David R. Birk is Senior Vice President, General Counsel and Secretary of Avnet, Inc., a Fortune 300 global distributor of electronic components and computer products headquartered in Phoenix, Arizona. As chief legal officer, he has worldwide responsibility for Avnet's legal department functions and, as corporate secretary, he works directly with the Board of Directors in establishing Avnet's corporate governance policies. He is a member of Avnet's executive board and is currently on a two-year tour of duty at Avnet's European headquarters in Diegem, Belgium.

Prior to joining Avnet in 1980, Mr. Birk was an associate attorney at the New York City firm of Jacobs Persinger and Parker and was a partner in the White Plains, New York firm of Burstein and Marcus. He has practiced principally in the areas of securities, litigation, corporate and real estate law.

He has served for many years as a member of the Corporation Law Committee of the New York State Bar Association and has done pro bono work for numerous community and educational programs. He was founding director of the Bedford (New York) Community Education Foundation and has served as a board member for the American Field Service foreign exchange program for its Arizona region.

Mr. Birk received a Bachelor of Arts degree in history from the University of Florida and a Juris Doctor degree from Cornell Law School.

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Avnet, Inc.
Corporate Governance Guidelines

A. Board Responsibilities

The fundamental responsibility of the Board of Directors is to promote the best interests of the Company and its shareholders by overseeing the management of the Company's business and affairs. In doing so, directors have two basic obligations to the Company and its shareholders: (1) the duty of care, which generally requires that directors exercise appropriate diligence in making decisions and in overseeing management of the Company, and (2) the duty of loyalty, which generally requires that directors make decisions based on the best interests of the Company and its shareholders and without regard to any personal interest.

In addition to its general oversight of management, the Board also performs a number of specific functions, including selecting and recommending to shareholders appropriate candidates for election to the Board; reviewing and approving significant transactions; selecting, regularly evaluating the performance of, and approving compensation for, the CEO; overseeing the implementation of the Company's succession plans; reviewing the business plans, major strategies and financial objectives of the Company; evaluating Board processes and performance and the overall effectiveness of the Board; and, in conjunction with senior management, setting the appropriate standard ("tone at the top") and ensuring that processes are in place for maintaining the integrity of the Company – including the integrity of the financial statements and public disclosures and compliance with law and ethics. The Board of Directors also recognizes that the long-term interests of shareholders are advanced by responsibly addressing the concerns of other stakeholders and interested parties including customers, suppliers, employees and the communities in which the Company operates.

Additional details regarding how the Board of Directors addresses some of these specific functions follows:

1. Board Evaluation

   The Board of Directors and its Committees (other than the Executive Committee) annually evaluates their performance to assess whether they are functioning effectively. The Corporate Governance Committee is responsible for facilitating the annual review process as well as for reviewing with the Board the results of these assessments.

2. CEO Evaluation

   The Compensation Committee is responsible for leading the Board in conducting an annual assessment of the Chief Executive Officer. Input is solicited from each director, analyzed by the Compensation Committee and reported to the full Board. Results of the evaluation are communicated to the CEO and considered in establishing CEO compensation.

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3. Management Succession Planning

The Board of Directors regularly reviews and discusses a management succession plan designed to provide for continuity in and development of senior management. This plan, on which the CEO reports at least annually, addresses (a) emergency CEO succession; (b) CEO succession in the ordinary course of business; and (c) succession for other members of senior management. The plan assesses senior management experience, performance, skills and planned career paths.

4. Strategic Planning Meetings

Each year the Board and the senior management team participate in a special meeting at which major long-term strategies, including direction, financial goals and other objectives and plans, are reviewed and discussed. The Board of Directors also reviews the annual operating plan and, on an ongoing basis, reviews the performance of the Company against the annual operating plan and long-term strategic plans.

B. Composition of the Board

1. Board Size

The Company believes that a Board of Directors ranging in size between eight and twelve members is appropriate. The Board may consider a somewhat larger size to accommodate the availability of one or more outstanding candidates and recognizes that a smaller size may result during transition periods.

2. Director Qualifications

The Corporate Governance Committee is responsible for developing and recommending Board membership criteria to the Board for approval and for reviewing with the Board from time to time the appropriate experience, skills and characteristics required of Board members. This assessment includes business experience, education and skills as well as character, judgment and issues of diversity in factors such as age, gender, race and culture. These factors, and others considered useful by the Board, are reviewed in the context of an assessment of the perceived needs of the Board at a particular point in time.

Directors should possess the highest personal and professional ethics, integrity and values and be committed to representing the long-term interests of the shareholders. Board members are expected to diligently prepare for, attend and participate in all Board and applicable Committee meetings. Each Board member is expected to ensure that other existing and future commitments do not materially interfere with the member's service as a director.

3. Board Membership Selection Process

The Board of Directors is elected each year by the shareholders at the Annual Meeting of Shareholders. The Board of Directors proposes a slate of nominees to the shareholders for election each year. The Board is also responsible for electing directors to fill vacancies on the Board that occur due to retirement, resignation, expansion of the Board or other reasons between the Shareholders' annual meetings.

The Board of Directors has delegated responsibility to the Corporate Governance Committee for identifying, screening and recommending candidates to the Board of Directors. The Committee places primary emphasis on the director qualification standards

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discussed above and is also responsible for initially assessing whether a candidate would be an Independent Director. The Committee considers nominations from shareholders, who may submit recommendations for director nominees to the Chair of the Committee, in care of the Corporate Secretary. Shareholders may also nominate directors for election at the Company's annual meeting of shareholders by following the provisions set forth in the Company's By-Laws.

4. Proportion of Independent Directors

It is the policy of the Company that at least a substantial majority of the members of the Board of Directors be Independent Directors. A director shall be independent (an "Independent Director") if he or she meets the definition of independence in the New York Stock Exchange rules, and any other specific Director Independence Standards that may be recommended by the Corporate Governance Committee from time to time and adopted by the Board.

5. Directors who Change Corporate Affiliation or Responsibilities

If a non-management director retires or changes the position he or she held when he or she first became a member of the Board, the director must notify both the Chairman of the Board and the Chairman of the Corporate Governance Committee of his or her change in affiliation or responsibilities. This notice provides an opportunity for the Board, through the Corporate Governance Committee, to review the continued appropriateness of Board membership under the changed circumstances.

6. Retirement Age

Non-management directors may not stand for election after age 72 or continue to serve beyond the Annual Shareholders Meeting following the attainment of age 72.

7. Directors' Service on Other Boards

Directors are expected to devote sufficient time to fulfill their responsibilities as directors of the Company. Each director is responsible to ensure that his or her affiliations or service on a board of directors of another company or charitable organization does not create any actual or perceived conflict of interest with his or her service on the Company's Board.

As a general policy, the Board recommends the following limits as to the service of directors on other boards of public companies: (1) the Company's Chairman of the Board and Chief Executive Officer may serve on up to two additional boards; (2) directors who are actively employed on a full-time basis may serve on up to two additional boards; and (3) directors who are retired from active full-time employment may serve on up to four additional boards.

Current positions in excess of these limits, as of September 19, 2003, may be maintained unless the Board determines that doing so would impair the Director's service on the Company's Board. All directors must provide written notice to the Corporate Governance Committee Chairman and the Chairman of the Board prior to accepting an invitation to serve on another Board. The Chairman of the Board and Chief Executive Officer must receive approval from the Corporate Governance Committee prior to beginning service on any additional board.

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C. Board Leadership

1. Selection of Chairman of the Board

Currently, and historically, the Board of Directors has combined the role of the Chairman of the Board with the Chief Executive Officer. The Board believes it has provided an efficient and effective leadership model for the Company. However, the Board of Directors has the flexibility to decide whether it is best for the Company at a given point in time for the roles of the Chief Executive Officer and Chairman of the Board to be separate or combined and, if separate, whether the Chairman should be selected from the Independent Directors or be an employee.

2. Lead Director

The Board of Directors has established a rotation system for Lead Director service. Each non-management director serves as the Lead Director from time to time as service rotates among directors on a quarterly basis. The Lead Director coordinates and develops the agenda for and chairs executive sessions of the non-management directors, facilitates communications between the Chairman of the Board and the other members of the Board with respect to meeting agendas and information needs, including requests to call special meetings of the Board or additional executive sessions, and performs such other duties as the Board may from time to time delegate to assist the Board in the fulfillment of its responsibilities.

D. Board Compensation and Stock Ownership Guidelines

From time to time, the Board conducts a review of the compensation of its directors in relation to similarly situated companies. Board compensation should be consistent with market practices but should not be set at a level that would call into question the Board's objectivity. The Board makes changes in its director compensation practices only upon the recommendation of the Corporate Governance Committee and following discussion and approval by the Board.

The Board believes that directors should hold meaningful equity ownership positions in the Company. To assist in accomplishing that objective, the Board believes that a significant portion of director compensation should be made in the form of Company equity.

In addition, the Board has adopted stock ownership guidelines providing that directors should own, within four years of joining the Board, 10,000 shares of Avnet, Inc. common stock. Shares that are awarded to directors as part of director compensation, as well as phantom shares acquired by directors under a deferred compensation plan, count towards the guideline. Directors on the Board at the time the guidelines were adopted in November 2000 have four years to accumulate sufficient shares to meet the guidelines. The Board will evaluate whether exceptions should be made in the case of any director who, due to his or her unique financial circumstances, would incur a hardship by complying with this requirement.

E. Board Operations

1. Meetings and Agendas

The Board of Directors meets a minimum of five times per fiscal year, including quarterly meetings and a special strategic planning meeting. Additional meetings, including telephonic meetings, are held from time to time as appropriate. The Chairman of the Board, with input from senior management, establishes the agenda for each Board meeting,

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although Board members are free to suggest items for inclusion on the agenda. Each director is free to raise at any Board meeting subjects that are not on the agenda for that meeting.

2. Distribution of Board Materials

Board packages, which include agendas and relevant background materials, are routinely distributed in advance of the regularly scheduled Board and Board committee meetings. Directors also routinely receive updates from the Chairman and CEO, press releases and other corporate communications, and other information designed to keep them informed about the Company's business.

3. Separate Executive Sessions

To ensure free and open discussion and communication among the non-management directors on the Board, executive sessions of the non-management directors are held at each regularly scheduled Board meeting.

4. Management Attendance at Board Meetings

The Board encourages senior management, from time to time, to bring managers into Board meetings who can provide additional insight concerning the items being discussed, or who have been identified as managers with future potential that the senior management believes should be given exposure to the Board.

5. Board Access to Senior Management

Directors have open access to the Company's senior management.

6. Directors' Relationship to Advisors and Authority to Retain

In performing its functions, the Board is entitled to rely on the advice, reports and opinions of senior management, counsel, auditors, accountants and expert advisors. The Board, and each Board Committee, has the authority to retain and approve the fees and retention terms of external legal, financial or other advisors as it deems appropriate.

F. Committee Matters

1. Committee Types and Responsibilities

The Board of Directors will at all times have an Audit Committee, a Compensation Committee, a Corporate Governance Committee and a Finance Committee, each consisting of at least three members. The Board of Directors may, from time to time, establish or maintain additional committees as necessary or appropriate. Each of the standing committees named above have charters that set forth the purpose and responsibilities of the committee. The Board expects to accomplish a substantial amount of its work through the committees. Each Committee reports regularly to the Board summarizing the Committee's actions and any significant issues considered by the Committee and each Committee will annually evaluate its performance.

The Board of Directors has also established an Executive Committee, chaired by the Chairman of the Board and comprised of four additional directors. Each director serves on the Executive Committee from time to time through a rotation system. The Executive Committee has all the authority of the Board of Directors between meetings of the Board,

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and is authorized to exercise the powers of the Board in the management of the business and affairs of the Corporation; subject, however, to the limitations prescribed by law.

2. Assignment of Committee Members

The Board of Directors, upon the recommendation of the Corporate Governance Committee, appoints committee members and names a Chair of each committee. The Corporate Governance Committee believes that rotation of committee assignments is beneficial and in making its recommendation to the Board, considers several factors, such as (a) each Board member's interests, tenure and subject-matter expertise, (b) the need for both continuity and fresh ideas and perspectives, and (c) applicable independence and qualification requirements. A director may serve on more than one committee but may serve as Chair on only one committee at any time.

3. Independence and Qualification

Each member of the Audit Committee, Compensation Committee and Corporate Governance Committee must meet applicable independence and qualification requirements of the New York Stock Exchange (the "NYSE"), the Securities Exchange Act of 1934 and any other applicable law.

4. Limit on Number of Outside Audit Committee Memberships

Given the significant time demands and responsibilities of serving on a public company audit committee, no member of the Audit Committee may serve on more than two other public company audit committees.

5. Committee Meeting Frequency, Length and Agendas

Each Committee shall have the number of meetings provided for in its charter, with further meetings to occur, or action may be taken by unanimous written consent, when deemed necessary or appropriate by the Committee or its Chair. The Chair of each Board committee, in consultation with the committee members and appropriate members of management, will develop the agenda and determine the length of each committee meeting.

Unless a Committee expressly determines otherwise, the agenda, materials and minutes for each Committee meeting shall be available to all directors, and all directors shall be free to attend any Committee meeting. In addition, all directors, whether or not members of the Committee, are free to make suggestions to a Committee chair for additions to the agenda of his or her Committee or to request that an item from a Committee agenda be considered by the Board.

G. Director Orientation and Continuing Education

1. New Director Orientation

The Company provides new directors with a director orientation program to familiarize such directors with, among other things, the Company's business, strategic plans, significant financial, accounting and risk management issues, compliance programs, conflicts policies, code of business conduct and ethics and corporate governance. New directors meet with senior management and the Company's independent auditors and have the opportunity to visit Company facilities. Sitting directors may also participate in any orientation programs.

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2. Director Continuing Education

Each director is expected to maintain the necessary level of expertise to perform his or her responsibilities as a director. The Company may, from time to time, offer continuing education programs in conjunction with scheduled Board meetings to assist the directors in maintaining such level of expertise and to continue to develop directors' knowledge of the Company and its operations. The Company encourages directors to attend continuing education programs, participate in professional associations and subscribe to appropriate publications and supports those efforts by reimbursing reasonable expenses.

3. Director Education Policy

The Corporate Governance Committee has adopted a Director Education Policy that outlines the details of these guidelines, including budgets for education activities and the Company's role in providing assistance to the directors in coordinating education resources.

H. Code of Business Conduct

The Company maintains, and the Audit Committee oversees compliance with, a code of business conduct and ethics for directors and all employees that addresses, at a minimum, conflicts of interest, corporate opportunities, confidentiality, proper use of Company assets, compliance with laws, rules and regulations, and reporting of any illegal or unethical behavior. In addition, the code of business conduct and ethics contains the specific requirements applicable to senior financial officers under the securities laws and other applicable regulations.

The Code of Conduct currently in effect shall be reviewed by the Audit Committee from time to time. Directors, as well as all employees, are subject to the Code of Conduct with respect to their director-related activities. The Company will continue to post the Code of Conduct on its intranet for use by employees and will also make it available to the public for review by posting the Code of Conduct on its website.

These Corporate Governance Guidelines were amended by the Board of Directors of Avnet, Inc. on August 13, 2004.

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AUDIT COMMITTEE CHARTER

Amended and Restated August 13, 2004

I. Purpose

The purpose of the Audit Committee is to represent and assist the Board of Directors in fulfilling its oversight responsibilities with respect to the integrity of the financial statements of the Company, the independence, qualifications and performance of the Company's corporate and external auditors, and compliance with legal and regulatory requirements, as well as the Company's policies for conducting business, as established in the Company's Code of Conduct, and to prepare the Audit Committee report for inclusion in the annual proxy statement.

II. Organization

A. Composition and Qualifications

1. The Audit Committee shall be appointed by the Board of Directors from time to time and shall consist of three or more directors, each of whom shall meet the independence requirements of the New York Stock Exchange for directors and audit committee members. The Board of Directors shall appoint one member of the Audit Committee as the Chair.

2. Each member of the Audit Committee shall be financially literate (as such qualification is interpreted by the Board of Directors in its business judgment). At least one member of the Audit Committee shall meet the audit committee financial expert requirements of the Securities and Exchange Commission, as determined by the Board of Directors.

B. Meetings / Minutes / Reports

1. The Audit Committee shall meet at least four times annually, or more frequently if circumstances dictate. At least two of these meetings shall be in person, while others may be conducted telephonically.

2. The Chair (or in his or her absence, a member designated by the Chair) shall preside at all meetings of the Audit Committee. The Chair shall be responsible for leadership of the Committee, including scheduling meetings, preparing agendas and making regular reports to the Board of Directors.

3. The Audit Committee shall have full access to management. The Audit Committee shall meet separately, periodically, with management, with corporate auditors and with external auditors to discuss any matters that the Committee believes are relevant to fulfilling its responsibilities.

4. Minutes of each Audit Committee shall be prepared and sent to all Audit Committee members.

5. The Audit Committee shall evaluate and assess the effectiveness of the Committee and the adequacy of this Audit Committee Charter on an annual basis and recommend any proposed changes to the Board of Directors.

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C. Authority

1. The Audit Committee shall have the authority to obtain advice and assistance from internal and outside legal, accounting or other advisors. The Company shall provide appropriate funding, as determined by the Audit Committee, for payment of compensation to the advisors employed by the Audit Committee.

2. The Audit Committee is authorized to conduct or originate investigations into any matters within the Committee's scope of responsibilities.

III. Responsibilities and Duties

A. Annual Audit

1. The Audit Committee shall meet with the external auditors and senior management prior to the annual audit to discuss planning and staffing of the audit.

2. The Audit Committee shall review the annual audited financial statements and discuss them with senior management and the external auditors, including the Company's MD&A disclosures. In connection with such review, the Audit Committee shall:

   a. Discuss with the external auditors the matters required to be discussed by Statements on Auditing Standards Nos. 61 and 90 relating to the Audit.

   b. Review significant issues regarding accounting principles, practices and judgments.

   c. Discuss any significant financial reporting issues arising in the fiscal year and the Company's accounting and disclosure thereof.

   d. Review with the external auditors any problems or difficulties encountered in the course of their audit, including any change in the planned audit work and any restrictions placed on the scope of such work, and management's response.

3. Based on its review of the audited financial statements and the external auditors' independence, the Committee shall make its recommendation to the Board of Directors as to the inclusion in the Company's audited financial statements in the Company's Report on Form 10-K.

4. The Audit Committee shall prepare the report of the Committee required by the rules of the SEC to be included in the Company's proxy statements for each annual meeting.

B. Quarterly Reviews

The Audit Committee shall discuss earnings press releases, and corporate practices with respect to earnings press releases, and financial information and earnings guidance provided to analysts and rating agencies. The Audit Committee shall discuss with management and the external auditors, the quarterly financial statements, including the Company's MD&A disclosures.

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C. Evaluation of External Auditors

1. The Audit Committee shall be directly responsible, in its capacity as a committee of the Board of Directors, for the appointment, compensation, retention and oversight of the work of the external auditors. In this regard, the Audit Committee shall appoint and retain (subject to ratification by the Company's shareholders), compensate, evaluate and terminate when appropriate, the Company's external auditors, which shall report directly to the Audit Committee.

2. The Audit Committee shall obtain confirmation and assurance as to the external auditors' independence including a requirement that the external auditors submit to the Audit Committee on a periodic basis, not less than annually, a formal written statement delineating all relationships between the external auditors and the Company, as well as a summary of all services provided by the external auditors and the fees charged for such services.

3. The Audit Committee shall also obtain and review at least annually, a report by the external auditor describing the audit firm's internal quality control procedures and any material issues raised by the most recent internal quality control review or peer review of the audit firm, or by any investigation by governmental or professional authorities within the preceding five years regarding any independent audit conducted by the firm and the steps taken to address such issues.

D. Oversee Corporate Audit Activities

1. The Audit Committee shall review the appointment or replacement and performance of the Director of Corporate Audit.

2. The Audit Committee shall review the plan and scope of corporate audit activities and budget and staffing of the corporate audit group. The Audit Committee shall review on a periodic basis with the Director of Corporate Audit, the progress of the proposed corporate audit plan, including explanations for any deviations from the original plan and any difficulties encountered in the course of their audits, including any restrictions on the scope of their work or access to required information.

3. The Audit Committee shall review the significant reports to management prepared by the corporate auditing group and management's response to such reports.

E. Business Ethics and Compliance Matters

1. The Audit Committee shall oversee the Company's compliance systems with respect to legal and regulatory requirements, including the Company's business ethics and compliance policies, training programs and programs to monitor compliance with such policies.

2. The Audit Committee shall establish procedures for the receipt, retention and treatment of complaints with respect to accounting, internal accounting controls or auditing matters, as well as for confidential anonymous submissions by the Company's employees with respect to questionable accounting or auditing matters.

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F. Internal Controls

1. The Audit Committee shall review with the external auditors and management the adequacy and effectiveness of the Company's internal controls, including any significant deficiencies or material weaknesses in internal controls reported to the Audit Committee by the external auditors or management.

2. The Audit Committee shall review with management the adequacy and effectiveness of the Company's disclosure controls and procedures.

3. The Audit Committee shall discuss policies with respect to risk assessment and risk management.

G. Hiring Policy.

The Audit Committee shall establish hiring policies for employees or former employees of the external auditor.

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Avnet, Inc. Board of Directors
Director Independence Standards

Adopted August 13, 2004

An "independent" director is a director who meets the New York Stock Exchange definition of "independence," as determined by the Board. The Board of Directors determines on an annual basis whether each Director is independent based upon the recommendation of the Corporate Governance Committee and all relevant facts and circumstances appropriate for consideration in the judgment of the Board. The Board applies the following standards in assessing independence:

No Director can qualify as independent if he or she has a material relationship with the Company outside of his or her service as a Director of the Company. A Director is not independent if, within the preceding three years

1. The director was an employee of the Company.
   - Employment as an interim Chairman or interim CEO shall not disqualify a director from being considered independent immediately following that employment.

2. An immediate family member of the director was an executive officer of the Company.

3. A director was affiliated with or employed by a present or former internal or external auditor of the Company.

4. An immediate family member of a director was affiliated with or employed in a professional capacity by a present or former internal or external auditor of the Company.

5. A director, or an immediate family member of the director, received more than $100,000 per year in direct compensation from the Company, other than director and committee fees and pension or other forms of deferred compensation for prior services (provided such compensation is not contingent in any way on continued service).
   - Compensation received by a director for former service as an interim Chairman or CEO need not be considered in determining independence under this test.
   - Compensation received by an immediate family member for service as a non-executive officer of the Company need not be considered in determining independence under this test.

6. The director, or an immediate family member of the director, was employed as an executive officer of another company where any of the Company's executives served on that company's compensation committee of the board of directors.

7. The director was an executive officer or employee, or an immediate family member of the director was an executive officer, of another company that made payments to, or received payments from, the Company for property or services in an amount which, in any single fiscal year, exceeded the greater of $1 million or two percent (2%) of such other company's consolidated gross revenues.

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8. The director, or an immediate family member of the director, was an executive officer of another company that was indebted to the company, or to which the Company was indebted, where the total amount of either company's indebtedness to the other was five percent (5%) or more of the total consolidated assets of the company he or she served as an executive officer.
    - For these purposes, "indebtedness" does not include trade payables.

9. The director, or an immediate family member of the director, was an officer, director or trustee of a charitable organization where the Company's annual discretionary charitable contributions to the charitable organization exceeded the greater of $1 million or five percent (5%) of that organization's consolidated gross revenues.

Definitions and Interpretations:

- "Immediate family member" includes a director's spouse, parents, children, siblings, mothers and fathers-in-law, sons and daughters-in-law, brothers and sisters-in-law, and anyone (other than domestic employees) who share such director's home. When applying the three-year "look back" period, the Company need not consider individuals who are no longer immediately family members as a result of legal separation or divorce, or those who have died or become incapacitated.

- "Affiliate" includes a general partner of a partnership, a managing member of a limited liability company or a greater than 10% shareholder of a corporation.

- In applying the financial tests in paragraphs 7, 8 and 9, the payments, consolidated gross revenues, debt, total consolidated assets and charitable contributions to be measured shall be those reported for the last completed fiscal year of the applicable organization.

- In applying the three-year look back period to paragraph 7, the three-year period relates only to the financial relationship between the Company and the director or immediate family member's current employer; the Company does not need to consider former employment of the director or immediate family member. Similarly, the three-year financial tests only need to be performed for companies where the director or immediate family member is currently an affiliate or executive officer, with respect to paragraph 8 relationships, or for a charitable organization where a director or immediate family member is currently an officer, director or trustee, for paragraph 9 relationships.

- To assist the Board in applying these categorical standards to particular situations, the Board may rely on any relevant rules, interpretations and defined terms provided by the New York Stock Exchange or the Securities and Exchange Commission.

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COMPENSATION COMMITTEE CHARTER

Amended and Restated August 13, 2004

I. Purpose

The purpose of the Compensation Committee is to assist the Board of Directors in fulfilling its responsibilities with respect to administering the Company's stock option plans and Incentive Stock Plan, to review and approve contracts and other arrangements for executives of the Company, to evaluate the performance of and set the compensation for the Chief Executive Officer, to prepare an annual report on executive compensation for inclusion in the proxy statement and to oversee the Company's diversity and community relations programs.

II. Organization

A. Composition and Qualifications

The Compensation Committee shall be appointed by the Board of Directors from time to time and shall consist of three or more directors, each of whom shall meet the independence requirements of the New York Stock Exchange. Additionally, members of the Compensation Committee must qualify as "non-employee directors" for purposes of Rule 16b-3 under the Securities Exchange Act of 1934, and as "outside directors" for purposes of Section 162(m) of the Internal Revenue Code. The Board of Directors shall appoint one member of the Committee as the Chair.

B. Meetings / Minutes / Reports

1. The Compensation Committee shall meet at least three times annually, or more frequently if circumstances dictate. At least two of these meetings shall be in person, while others may be conducted telephonically.

2. The Chair (or in his or her absence, a member designated by the Chair) shall preside at all meetings of the Compensation Committee. The Chair shall be responsible for leadership of the Committee, including scheduling meetings, preparing agendas and making regular reports to the Board of Directors.

3. The Compensation Committee shall have complete access to management. The Compensation Committee may invite members of management or others to attend the Committee's meetings and provide pertinent information as appropriate.

4. Minutes of each Compensation Committee shall be prepared and sent to all Compensation Committee members.

5. The Compensation Committee shall evaluate and assess the effectiveness of the Committee and the adequacy of this Compensation Committee Charter on an annual basis and recommend any proposed changes to the Board of Directors.

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C. Authority

1. The Compensation Committee shall have the authority to retain and approve the fees and retention terms of external legal, accounting or other advisors as it deems appropriate.

III. Responsibilities and Duties

1. The Compensation Committee shall oversee the Company's overall compensation structure, policies and programs, and assess whether the Company's compensation structure establishes appropriate incentives for management and employees.

2. The Compensation Committee shall administer the Company's stock option plans, the Incentive Stock Program and all other employee equity-based compensation plans, with full authority to construe the same, prescribe and amend the rules and regulations related thereto and make all other determinations in the administration thereof, subject however, to the limitations prescribed by law and in such plans and programs.

3. The Compensation Committee shall review and approve corporate goals and objectives relevant to Chief Executive Officer's compensation, evaluate the CEO's performance in light of those goals and objectives, and determine and approve the CEO's compensation level based on such evaluation.

4. The Compensation Committee shall review the compensation and oversee the evaluation of executives of the Company other than the CEO, particularly the executive officers whose total salary and target bonus exceed $500,000 in any fiscal year and the four most highly compensated executive officers, whether or not their total compensation exceeds $500,000.

5. The Compensation Committee shall produce an annual report on executive compensation for inclusion in the Company's proxy statement.

6. The Compensation Committee shall oversee and review periodic reports with respect to the Company's diversity program.

7. The Compensation Committee shall oversee and review periodic reports with respect to the Company's community relations program, including charitable contributions and activities.

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CORPORATE GOVERNANCE COMMITTEE CHARTER

Amended and Restated August 13, 2004

I. Purpose

The purpose of the Corporate Governance Committee is to identify (consistent with criteria approved by the Board), screen and recommend to the Board of Directors appropriate candidates to serve as Directors of the Company, to oversee the process for evaluating the performance of the Board and to develop, recommend to the Board and monitor corporate governance guidelines applicable to the Company.

II. Organization

A. Composition and Qualifications

The Corporate Governance Committee shall be appointed by the Board of Directors from time to time and shall consist of three or more directors, each of whom shall meet the independence requirements of the New York Stock Exchange. The Board of Directors shall appoint one member of the Corporate Governance Committee as the Chair.

B. Meetings / Minutes / Reports

1. The Corporate Governance Committee shall meet at least three times annually, or more frequently if circumstances dictate. At least two of these meetings shall be in person, while others may be conducted telephonically.

2. The Chair (or in his or her absence, a member designated by the Chair) shall preside at all meetings of the Corporate Governance Committee. The Chair shall be responsible for leadership of the Committee, including scheduling meetings, preparing agendas and making regular reports to the Board of Directors.

3. The Corporate Governance Committee shall have complete access to management. The Corporate Governance Committee may invite members of management or others to attend the Committee’s meetings and provide pertinent information as appropriate.

4. Minutes of each Corporate Governance Committee shall be prepared and sent to all Corporate Governance Committee members.

5. The Corporate Governance Committee shall evaluate and assess the effectiveness of the Committee and the adequacy of this Corporate Governance Committee Charter on an annual basis and recommend any proposed changes to the Board of Directors.

C. Authority

1. The Corporate Governance Committee shall have the authority to retain and approve the fees and retention terms of external legal or other advisors, as it deems appropriate.

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III. Responsibilities and Duties

A. Board Matters

1. The Corporate Governance Committee shall develop and recommend to the Board of Directors for approval, criteria to identify, assess the qualifications of and evaluate candidates for the Board of Directors. Based on such criteria and evaluation, the Committee shall recommend to the Board of Directors candidates to be elected by the shareholders at each annual shareholders' meeting, and as necessary to fill vacancies and newly created directorships.

2. The Corporate Governance Committee shall evaluate the contributions and independence of incumbent Directors to determine whether to recommend them for reelection. Based on such evaluation, the Committee shall recommend to the Board of Directors candidates for reelection to the Board at each annual shareholders' meeting.

3. The Corporate Governance Committee shall establish a procedure for the consideration of Board candidates recommended by the Company's shareholders.

4. The Corporate Governance Committee shall make recommendations to the Board of Directors concerning the structure, composition and functioning of the Board and its committees, and shall recommend to the Board candidates for appointment to Board committees.

5. The Corporate Governance Committee shall review the compensation of directors for service on the Board and its Committees and recommend changes in compensation to the Board.

6. Monitor compliance by directors with the Company's stock ownership guidelines.

B. Governance Guidelines

1. The Corporate Governance Committee shall develop and recommend to the Board of Directors a set of corporate governance guidelines.

2. The Corporate Governance Committee shall periodically review and assess the adequacy of the Corporate Governance Guidelines of the Company and recommend any proposed changes to the Board of Directors for approval.

C. Succession Planning

The Corporate Governance Committee shall periodically review the Company's succession plans with respect to the Chief Executive Officer and other senior management members.

D. Evaluations

The Corporate Governance Committee shall determine the process for and facilitate the annual evaluation of the Board of Directors and its Committees. The Committee shall review the evaluation, report to the Board of Directors with respect to the evaluation and make recommendations to the Board regarding any proposed changes.

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THE BELGIAN CODE ON CORPORATE GOVERNANCE

9 December 2004

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THE BELGIAN CODE ON CORPORATE GOVERNANCE

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FOREWORD

Our companies face a challenging environment characterised by significant change, such as the globalisation of markets, the modernisation of communication technologies and the enlargement of the EU, to name but a few. In such an environment, companies should benefit from a regulatory framework that encourages efficiency and competitiveness while fostering sound and transparent corporate governance practices.

It is with that aim in mind that the European Commission launched in 2003 its Action Plan on 'Modernising Company Law and Enhancing Corporate Governance in the European Union' (hereinafter "EU Action Plan"). The Plan is currently being implemented by the EU Commission through various legal initiatives aimed at improving governance and strengthening shareholders' rights. In Belgium, there were three separate sets of rules drawn up by different authorities, in need of updating and consolidation.

In this context, at the initiative of the Banking, Finance and Insurance Commission (BFIC), Euronext Brussels and the Federation of Belgian Enterprises (FEB-VBO), a Committee was established to draft a single code of best practice on corporate governance for all listed companies. The Committee's aim was to draft a Code aligned with international practice and EU recommendations.

On 18 June 2004, a first draft was published for consultation on the Committee's website. The public consultation was a success. The comments received, together with recent EU Commission initiatives, helped the Committee to finalise the Code published on 9 December 2004.

The Code has a high degree of built-in flexibility, enabling it to be adapted to each company's varying size, activities and culture. It is based on a 'comply or explain' system, which allows companies to deviate from the provisions of the Code when their specificities so justify, subject to providing adequate explanation.

In line with the EU Action Plan, the government must designate a national corporate governance code. In this respect, the Committee recommends that Belgian authorities consider designating this Code as the Belgian code of reference.

Monitoring of compliance with the Code will rely on shareholders and market authorities, and may involve other mechanisms.

The Committee believes that the Code should lend itself to revision in the future in order to take account of the experience gained and the changes in legal and business practices. Therefore, the Committee will endeavour to have proper follow-up in place.

In the name of the Committee, I wish to thank all those who contributed to this Code for their help.

Maurice Lippens

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PREAMBLE

1 What is good corporate governance?

Corporate governance is a set of rules and behaviours according to which, companies are managed and controlled. A good corporate governance model will achieve its goal by setting a proper balance between entrepreneurship and control, as well as between performance and conformance.

For **entrepreneurship**, corporate governance rules should not only facilitate performance-driven direction, but should also provide mechanisms for direction and leadership while ensuring integrity and transparency in the decision-making process.

Good corporate governance should help determine a company's objectives, the means through which these objectives are attained and how performance is to be evaluated. In this sense, corporate governance should provide incentives for the board and management to pursue objectives that are in the interest of the company, its shareholders and other stakeholders.

Control means effective evaluation of performance, careful management of potential risks, and proper supervision of conformity with agreed procedures and processes.
Here, the emphasis is on monitoring whether robust control systems are effectively in operation, whether potential conflicts of interest are managed and whether sufficient checks are in place to prevent abuse of power leading to private benefits prevailing over corporate benefits.

2 Main aim of the Code

This Code's main objective is to support long-term value creation. Business success demonstrates that good governance leads to creation of wealth, not only for shareholders but also for all other stakeholders. Recent examples of corporate malpractice, however, have shown that failing corporate governance may lead to significant losses well beyond the loss of shareholder capital.
Governance practices, based on transparency and accountability, will reinforce the confidence of investors in companies and will benefit other stakeholders. Good governance will enable companies to access external funding at a lower cost. Good corporate governance will also bring macro-economic advantages, such as improving economic efficiency and growth, and protecting private investments.

3 Reference context of the Code

This Corporate Governance Code has to be seen as complementary to existing Belgian legislation; no provision of the Code may be interpreted as derogating from Belgian law.

In formulating the Code, the Committee based itself on the existing Belgian legislation applicable to companies, in particular the provisions of the Belgian Code on Companies and financial law applicable to listed companies.

In developing the Code, the Committee also paid great attention to the European Commission's recent initiatives in the field of corporate governance, more specifically those implementing the Commission's plan adopted in 2003 ('Modernising Company Law and Enhancing Corporate Governance in the European Union').

The Code has been drawn up with the 'one-tier board' model in mind and other Belgian specificities such as their shareholding structure. That choice is justified by the current practice in Belgium.

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4 Structure, content and character of the Code

The Committee has opted for a flexible approach based on a 'comply or explain' system. The 'comply or explain' approach has been in operation in several countries for many years and the flexibility it offers has been widely welcomed by both company boards and investors. This approach is also favoured by the OECD and the European Commission.

Indeed, the strict and rigid application of a detailed set of rules would not allow the taking into account of companies' specificities, such as size, shareholding structure, activities, exposure to risks and management structure. A code based on a rigid approach would therefore be unlikely to be followed by the companies at which it is aimed.

The Code contains three sets of rules: **principles, provisions** and **guidelines.**
The Committee has formulated nine **principles** that in its opinion form the pillars on which good corporate governance should rest. The principles are broad enough for all companies to be able to adhere to them, whatever their specificities. All companies should apply them without exception.

Provisions (some of which are further substantiated in Appendices) are recommendations describing how to apply the principles. Companies are expected to comply with these provisions or explain why, taking into account their specific situation, they do not comply. Indeed, while it is expected that listed companies will comply with the Code's provisions most of the time, it is recognised that departure from the provisions of the Code may be justified in particular circumstances. Smaller listed companies, in particular those new to listing, as well as young growth companies, may judge that some provisions are disproportionate or less relevant in their case. Also, holding companies and investment companies may need a different board structure, which may affect the relevance of some provisions. In those cases, companies should determine what they consider to be the best rules in their specific situation and provide an explanation ('explain') in the Corporate Governance Chapter of the annual report.

The provisions are supplemented with **guidelines**, which provide guidance as to how the company should implement or interpret the provisions laid down in the Code. Most guidelines are qualitative and do not lend themselves to assessment in terms of compliance. The obligation to comply or explain does not therefore apply to those guidelines.

5 Disclosure

Disclosure, leading to transparency, is an essential ingredient of the Code. Indeed, disclosure is crucial to allow outside monitoring to function effectively. Hence the Codes' provisions aim at putting in place a high level of transparency concerning companies' corporate governance.

Transparency is obtained through disclosure in two different documents; the **Corporate Governance Charter**, posted on a company's website, and the **Corporate Governance Chapter** of the annual report.

In the Corporate Governance Charter, the company will describe the main aspects of its corporate governance, such as its governance structure, the terms of reference of the board and its committees and other important topics (e.g. remuneration policy). The Corporate Governance Charter should be updated regularly.

The Corporate Governance Chapter of the annual report should include more factual information relating to corporate governance, including changes to the company's corporate governance together with relevant events that took place during the year under review, such as appointment of new directors, designation of committee members, or the annual remuneration received by members of the board.

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6 Monitoring & Compliance

Unlike in some neighbouring countries, Belgian listed companies are often controlled by one or more major shareholders. Therefore, one cannot rely on market monitoring alone to guarantee adequate compliance with the Code by listed companies. Hence, the Committee has opted for a combined monitoring system relying on the board, the company's shareholders and the Banking, Finance and Insurance Commission (BFIC), possibly complemented with other mechanisms.

- **The Board**

  In a 'one-tier board' model, the board has a dual role to play, to support entrepreneurship and to ensure effective monitoring and control. Hence, to be able to play its role as the guardian of corporate interest, it is important that the board is composed of both executive and non-executive directors, including independent non-executive directors. All directors should demonstrate independence of judgement, and objectivity in making board decisions but the independent directors will have a crucial role to play in that respect. It is the board's responsibility to see to the accuracy and completeness of the Corporate Governance Charter and Corporate Governance Chapter of the annual report.

- **Shareholders**

  Given the reliance of the Code on a flexible 'comply or explain' approach, shareholders, and in particular institutional investors, should play an important role in carefully evaluating a company's corporate governance and should give weight to all relevant factors drawn to their attention.

  Shareholders should carefully consider explanations given for deviations from the Code and make reasoned judgments in each case. They should be prepared to enter into a dialogue if they do not accept the company's position, bearing in mind in particular the size and complexity of the company and the nature of the risks and challenges it faces.

  Controlling shareholders can appoint representatives to the board. They are therefore in a position to monitor both from the inside and the outside of the company, with the benefits and risks that such a strong position may entail. Controlling shareholders should thus make considered use of their position and respect the rights and interests of minority shareholders.

- **BFIC**

  The Banking Finance and Insurance Commission (BFIC) acting within its mission of supervision of the periodic and ongoing information obligations of listed companies, as laid down in the law of August 2, 2002, will contribute to the external monitoring of the Code. It will lend its moral support to the implementation of the disclosure provisions which the Code addresses to Belgian listed companies, in addition to the obligations imposed by the applicable laws and regulations.

  The existence and the acceptance by the Belgian financial world of a single Code on corporate governance (initiated by FEB and Euronext Brussels) will contribute to the reinforcement of the Belgian financial market and the confidence of the investors.

  As was the case with its 1998 Recommendations, the BFIC recommends listed companies to disclose relevant information about their corporate governance rules and practices in accordance with the provisions of the Code. It is up to the listed companies to determine whether they comply with the Code's provisions, or explain their reasons for non compliance. In case, contrary to Principle 9 and Appendix F, no disclosure about a specific item as identified in the Code has been made, the BFIC intends, within the framework of its control program, to draw the attention of the listed company to that fact and invite it to disclose, as the case may be, the reasons for not complying with the

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specific Code's provision. The BFIC's role is limited to verifying the observance of the "comply or explain" principle, and to invite companies to live up to it. Moreover, the BFIC intends to publish, from time to time, general comparative overviews of corporate governance practices in Belgian listed companies.

However, with respect to the disclosure items that are imposed pursuant to the applicable laws or regulations - whether or not said items are part of the Code - the BFIC's competences, including its powers to impose sanctions, remain unchanged. Its role in the external monitoring the Code does not alter its legally mandated supervisory responsibility.

7 Follow-up

The Committee also feels that what constitutes good corporate governance will evolve with changing business circumstances and international financial markets requirements. It will therefore be important to ensure a regular review of corporate governance practices and the adaptation of the recommendations. This will require the setting up of an appropriate mechanism.

At the invitation of Parliament, the Committee will continue to reflect, with the Government, on the most suitable follow-up of this Code. Meanwhile, the Committee will remain active for a transitional period.

8 Scope of application and entry into force

The Code applies to companies incorporated in Belgium whose shares are traded on a regulated market (listed companies). However, given its flexibility, the Code could also function as a reference framework for all other companies.

The Code replaces the existing Belgian codes on corporate governance for Belgian listed companies i.e. the 'Recommendations from the Federation of Belgian Companies' published in January 1998 and the Recommendations issued in December 1998 by the Brussels Stock Exchange (now Euronext Brussels) and the Banking and Finance Commission (now BFIC).

This Code enters into force on 1 January 2005. At the general meeting held in 2005, corporate governance should be an item on the agenda for information and consideration. Where possible, there could already be a statement in the annual report for the year 2004, published in 2005, to that effect.

As from 1 January 2006, listed companies should have made public a Corporate Governance Charter, outlining their corporate governance structure and policies.

In the annual report for the year 2005, published in 2006, listed companies will be expected to devote a specific chapter to corporate governance, describing their governance practices during that year and including explanations, where applicable, on deviations from the Code.

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THE CORPORATE GOVERNANCE PRINCIPLES

PRINCIPLE 1. THE COMPANY SHALL ADOPT A CLEAR GOVERNANCE STRUCTURE

1.1. Every company should be headed by a collegial board. The company should define and disclose the board's terms of reference in its Corporate Governance Charter (hereinafter "CG Charter").

Guideline The board's role should be to pursue the long-term success of the company by providing entrepreneurial leadership and enabling risks to be assessed and managed.

Guideline The board's responsibilities should be defined in the articles of association of the company and in the terms of reference of the board. It is the board's duty to define its terms of reference detailing its responsibilities, duties, composition and operation, within the limits defined by the articles of association of the company.

Guideline The board should be organised in such a way that it is able to perform its tasks efficiently.

Guideline The company should adapt its governance structure to its evolving needs.

1.2. The board should decide on the company's values and strategy, its risk appetite and key policies.

Guideline The board should ensure that the necessary financial and human resources are in place for the company to meet its objectives.

1.3. With respect to its monitoring responsibilities, the board should:

- review the existence and functioning of a system of internal control, including adequate identification and management of risks (including those relating to compliance with existing legislation and regulations);
- take all necessary measures to ensure the integrity of the company's financial statements;
- review executive management performance;
- supervise the performance of the external auditor and supervise the internal audit function.

1.4. The board should decide on the executive management structure and determine the powers and duties entrusted to executive management. These should be included in the terms of reference of the board and in those of executive management.

1.5. There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. The chairman of the board and the chief executive officer (hereinafter "CEO") should not be the same individual. The division of responsibilities between the chairman and the CEO should be clearly established, set out in writing and agreed by the board.

Guideline The chairman should establish a close relationship with the CEO, providing support and advice, while fully respecting the executive responsibilities of the CEO.

1.6. The board should ensure that its obligations to all its shareholders are understood and met. It should account to shareholders for the discharge of its responsibilities.

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PRINCIPLE 2. THE COMPANY SHALL HAVE AN EFFECTIVE AND EFFICIENT BOARD TAKING DECISIONS IN THE CORPORATE INTEREST

2.1. The board's composition should ensure that decisions are made in the corporate interest. It should be determined on the basis of the necessary diversity and complementary skills, experience and knowledge. A list of the members of the board should be disclosed in the Corporate Governance Chapter of the annual report (hereinafter "CG Chapter of the annual report").

Guideline The board should be small enough for efficient decision-making. It should be large enough for its members to contribute experience and knowledge from different fields and for changes to the board's composition to be managed without undue disruption.

2.2. No individual or group of directors should dominate the board's decision-making. No one individual should have unfettered powers of decision-making. At least half the board should comprise non-executive directors and at least three of them should be independent.

Guideline A non-executive director is any member of the board who has no executive responsibilities in the company.

2.3. To be considered independent, a director should be free from any business, close family or other relationship with the company, its controlling shareholders or the management of either that creates a conflict of interest such as to affect that director's independent judgement.

Guideline A controlling shareholder is a shareholder who solely or in concert, directly or indirectly controls a company in the meaning of Article 5 of the Code on Companies.

In assessing independence, the criteria set out in appendix A should be taken into account.

The company should disclose which directors it considers to be independent. If one or more of the criteria in appendix A are not met, the company should disclose its reasons for nevertheless considering this director to be independent.

An independent director who ceases to satisfy the requirements of independence should immediately inform the board.

2.4. The chairman is responsible for the leadership of the board. He or she should take the necessary measures to develop a climate of trust within the board, contributing to open discussion, constructive dissent and support for the board's decisions.

Guideline The chairman should promote effective interaction between the board and the executive management.

Guideline The board may entrust the chairman with other specific responsibilities.

2.5. The chairman sets the agenda of the board meetings, after consultation with the CEO, and ensures that procedures relating to preparatory work, deliberations, passing of resolutions and implementation of decisions are properly followed. The minutes of the meeting should sum up the discussions, specify any decisions taken and state any reservations voiced by directors.

Guideline The agenda should list the topics to be discussed and specify whether they are for information, for deliberation or for decision-making purposes.

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2.6. The chairman is responsible for ensuring that the directors receive accurate, timely and clear information before the meetings and, where necessary, between meetings. All directors should receive the same board information.

Guideline The chairman should ensure that all directors can make a knowledgeable and informed contribution to board discussions and that there is sufficient time for consideration and discussion before decision-making.

Guideline Directors should have access to independent professional advice at the company's expense, subject to compliance with the relevant procedure laid down by the board.

2.7. The number of board and board committee meetings and the individual attendance record of directors should be disclosed in the CG Chapter of the annual report.

Guideline The board should meet sufficiently regularly to discharge its duties effectively.

2.8. The board should appoint a company secretary reporting to the board on how board procedures, rules and regulations are followed and complied with. Where necessary, the company secretary should be assisted by the company lawyer. Individual directors should have access to the company secretary.

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PRINCIPLE 3. ALL DIRECTORS SHALL DEMONSTRATE INTEGRITY AND COMMITMENT

3.1. Independence of judgement is required in the decisions of all directors, executive and non-executive alike, whether the non-executive directors are independent or not.

3.2. Directors should make sure they receive detailed and accurate information and should study it carefully so as to acquire and maintain a strong command of the key issues relevant to the company's business. They should seek clarification whenever they deem it necessary.

3.3. While executive and non-executive directors are part of the same collegial body, they have each a specific and complementary role to play on the board.

Guideline Executive directors should provide all relevant business and financial information for the board to function effectively.

Guideline Non-executive directors should constructively challenge and help develop strategy and key policies proposed by executive management.

Guideline Non-executive directors should scrutinise the performance of executive management in meeting agreed goals.

3.4. Directors cannot use the information obtained in their capacity as director for purposes other than for the exercise of their mandate.

Guideline Directors have an obligation to handle with caution the confidential information received in their capacity as director.

3.5. Each member of the board should arrange his or her personal and business affairs so as to avoid direct and indirect conflicts of interest with the company. All directors should inform the board of conflicts of interest as they arise and abstain from voting on the matter involved in accordance with the relevant provisions of the Code on Companies. Any abstention from voting, motivated by a conflict of interest, should be disclosed in accordance with the relevant provisions of the Code on Companies.

3.6. The board should establish a policy for transactions or other contractual relationships between the company, including its related companies, and its board members, which are not covered by the legal provisions on conflicts of interest. This policy should be disclosed in the CG Charter. Comments on the application of this policy should be disclosed in the CG Chapter of the annual report. Transactions between the company and its board members should take place at arms' length.

3.7. The company should take all necessary and useful measures to comply with Directive 2003/6/EC on insider dealing and market manipulation (market abuse). In this respect it should at least adhere to the provisions and guidelines laid down in Appendix B.

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PRINCIPLE 4. THE COMPANY SHALL HAVE A RIGOROUS AND TRANSPARENT PROCEDURE FOR THE APPOINTMENT AND EVALUATION OF THE BOARD AND ITS MEMBERS

Nomination and appointment

4.1. There should be a rigorous and transparent procedure for an efficient appointment and re-election of directors. The board should draw up nomination procedures and selection criteria for board members, allowing for specific rules for executive and non-executive directors where appropriate.

4.2. The chairman of the board or another non-executive director should lead the nomination process. The nomination committee should recommend suitable candidates to the board. The board should then make proposals for appointment or re-election to the general meeting of shareholders.

4.3. For any new appointment to the board, the skills, knowledge and experience already present and those needed on the board should be evaluated and, in the light of that evaluation, a description of the role and skills, experience and knowledge needed should be prepared (also referred to as a 'profile').

4.4. When dealing with a new appointment, the chairman of the board should ensure that, before considering the candidate, the board has received sufficient information such as the candidate's résumé (CV), the assessment of the candidate based on the candidate's initial interview, a list of the positions the candidate currently holds, and, if applicable, the necessary information for assessing the candidate's independence.

4.5. Non-executive directors should be made aware of the extent of their duties at the time of their application, in particular as to the time commitment involved in carrying out those duties. They should not consider taking on more than five directorships in listed companies. Changes to their other relevant commitments and their new commitments outside the company should be reported to the chairman of the board as they arise.

Guideline — Non-executive directors should undertake to have sufficient time to meet what is expected of them, taking into account the number and importance of their other commitments.

4.6. Any proposal for the appointment of a director by the shareholders' meeting should be accompanied by a recommendation from the board, based on the advice of the nomination committee.

The proposal should specify the proposed term of the mandate, which should not exceed four years. It should be accompanied by relevant information on the candidate's professional qualifications together with a list of the positions the candidate already holds.
The board will indicate whether the candidate satisfies the independence criteria.

Without prejudice to applicable legal provisions, proposals for appointment should be communicated at least 24 days before the general meeting, together with the other points on the agenda of the general meeting.
This provision also applies to proposals for appointment originating from shareholders.

4.7. The board should designate its chairman.

Induction

4.8. The chairman should ensure that newly appointed directors receive an appropriate induction to ensure their early contribution to the board.

Guideline — The induction process should help the director grasp the fundamentals of the company, including its governance, strategy, key policies, finance and business challenges.

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4.9. For directors joining board committees, the induction provided should encompass a description of their specific role and duties and any other information linked to the specific role of that committee.

Guideline For new audit committee members, this programme should cover the audit committee's terms of reference and provide an overview of the company's internal control organisation and risk management systems.. They should be provided in particular with full information on the company's specific accounting, financial and operational features. This induction should also include meeting the external auditor and the relevant company staff.

4.10. Directors should update their skills and improve their knowledge of the company to fulfil their role both on the board and on board committees.

Guideline Necessary resources should be available for developing and updating directors' knowledge and skills.

Evaluation

4.11. Under the lead of its chairman, the board should regularly (e.g. at least every two to three years) assess its size, composition, operation and interaction with executive management.

Guideline Regular evaluation by the board of its own effectiveness should promote continuous improvement in the governance of the company.

Guideline The evaluation process should have four objectives:

- assessing how the board operates;
- checking that the important issues are suitably prepared and discussed;
- evaluating the actual contribution of each director's work, the director's presence at board and committee meetings and his constructive involvement in discussions and decision-making;
- checking the board's current composition against the board's desired composition.

Guideline Although evaluation is a board responsibility, the board should be assisted in this evaluation by the nomination committee, and possibly also by external experts.

4.12. The non-executive directors should regularly (preferably once a year) assess their interaction with executive management. In this respect, non-executive directors should meet at least once a year in absence of the CEO and the other executive directors.

4.13. There should be a periodic evaluation of the contribution of each director aimed at adapting the composition of the board to take account of changing circumstances. When dealing with re-election, the director's commitment and effectiveness should be evaluated in accordance with a pre-established and transparent procedure.

Guideline Special attention should be given to the evaluation of the chairman of the board and the chairmen of the committees.

4.14. The board should act on the results of the performance evaluation by recognising its strengths and addressing its weaknesses. Where appropriate, this will involve proposing new members for appointment, proposing not to re-elect existing members or taking any measure deemed appropriate for the effective operation of the board.

Guideline The board should satisfy itself that plans are in place for orderly succession for appointments to the board. It should satisfy itself that any appointment and re-election, whether of executive or non-executive directors, will allow an appropriate balance of skills and experience to be maintained on the board.

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PRINCIPLE 5. THE BOARD SHALL SET UP SPECIALISED COMMITTEES

5.1. The board should set up specialised committees to analyse specific issues and advise the board on those issues. The decision-making remains within the collegial responsibility of the board. The board should determine and disclose in the CG Charter the terms of reference of each committee detailing its role, composition and operation.

5.2. The board should set up an audit committee to assist the board in fulfilling its monitoring responsibilities in respect of control in the broadest sense. The audit committee should follow the provisions set out in appendix C.

5.3. The board should set up a nomination committee following the provisions set out in appendix D.

5.4. The board should set up a remuneration committee following the provisions set out in appendix E.

Guideline — The nomination committee and the remuneration committee may be combined provided the combined committee satisfies the composition requirements for the remuneration committee.

5.5. The chairman of the board should ensure that the board appoints committee members and a chairman for each of those committees. Each committee is composed of at least three members. Designation should not be for a term exceeding that of board membership.

Guideline — In deciding on the specific composition of a committee, consideration should be given to the needs and qualifications required for the optimal functioning of that committee.

Guideline — Each committee may invite any non-member to attend its meetings.

5.6. Board committees should be entitled to seek external professional advice at the company's expense after informing the chairman of the board.

5.7. After each committee meeting, the board shall receive from each committee a report on its findings and recommendations.

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PRINCIPLE 6. THE COMPANY SHALL DEFINE A CLEAR EXECUTIVE MANAGEMENT STRUCTURE

6.1. The board should determine, in close consultation with the CEO, the terms of reference of the executive management detailing its responsibilities, duties, powers, composition and operation. These terms should be disclosed in the CG Charter.

6.2. Executive management should at least include all executive directors. If there exists a management committee, executive management also includes all members of that committee, whether or not the committee is established within the scope of Article 524bis of the Code on Companies. A list of the members of the executive management should be disclosed in the CG Chapter of the annual report.

6.3. The nomination committee should assist the board for the nomination and succession planning of executive management, unless otherwise decided by the board.

6.4. The board should empower executive management to enable it to perform its responsibilities and duties. Taking into account the company's values, its risk appetite and key policies, executive management should have sufficient latitude to propose and implement corporate strategy.

6.5. Executive management should :

- be entrusted with the running of the company;
- put internal controls in place (i.e. systems to identify, assess, manage and monitor financial and other risks), without prejudice to the board's monitoring role;
- be responsible and accountable for the complete, timely, reliable and accurate preparation of the company's financial statements, in accordance with the accounting standards and policies of the company;
- present the board with a balanced and understandable assessment of the company's financial situation;
- provide the board in due time with all information necessary for the board to carry out its duties;
- be accountable to the board for the discharge of its responsibilities.

6.6. Clear procedures should exist for:

- proposals from executive management for decisions to be made by the board;
- the decision-making by executive management;
- the reporting to the board of key decisions made by executive management.

These procedures should be reviewed and adjusted when required for the effective exercise by the board and executive management of their respective powers and duties.

Guideline — The powers to represent the company solely or jointly and the extent of, and limitations on, those powers shall be clearly defined, taking into account the way in which the board entrusted executive management with the running of the company and the relevant provisions of the Code on Companies. All concerned should be fully acquainted with the scope of those powers.

6.7. Provision 3.6. applicable to transactions between the company and directors also applies to transactions between the company and executive managers.

6.8. Provision 3.7. applicable to transactions between the company and directors also applies to transactions between the company and executive managers.

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PRINCIPLE 7. THE COMPANY SHALL REMUNERATE DIRECTORS AND EXECUTIVE MANAGERS FAIRLY AND RESPONSIBLY

7.1. Levels of remuneration should be sufficient to attract, retain and motivate directors and executive managers who have the profile determined by the board.

7.2. The company should disclose its remuneration policy in its CG Charter.

Non-executive directors' remuneration

7.3. The remuneration of non-executive directors should take into account their responsibilities and time commitment.

7.4. Non-executive directors should not be entitled to performance-related remuneration such as bonuses, stock related long-term incentive schemes, fringe benefits or pension benefits.

Guideline Under Belgian law, any director's mandate may be terminated “ad nutum” (at any time) without any form of compensation.

7.5. In the CG Chapter of the annual report, the company should disclose on an individual basis the amount of the remuneration and other benefits granted directly or indirectly to non-executive directors, by the company or any other undertaking belonging to the same group.

Executive directors' remuneration

7.6. Provisions on the remuneration of non-executive directors apply to the remuneration of executive directors in their capacity as board members.

7.7. Provisions on the remuneration of executive managers apply to the remuneration of executive directors in their executive capacity.

Executive managers' remuneration

7.8. The board should determine formal and transparent procedures on the remuneration of executive managers. No individual should be involved in deciding his or her own remuneration.

7.9. The board determines the remuneration policy for executive managers.

Guideline The level and structure of the remuneration of executive managers should be such that qualified and expert professionals can be recruited, retained and motivated, taking into account the nature and scope of their individual responsibilities.

7.10. If an executive manager is also an executive director, the remuneration should be determined taking into account the compensation received in that person's capacity as a board member.

7.11. An appropriate proportion of an executive manager's remuneration package should be structured so as to link rewards to corporate and individual performance, thereby aligning the executive managers' interest with the interest of the company and its shareholders.

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7.12. Where executive managers are eligible for incentives, their grant should be subject to relevant and objective performance conditions designed to enhance corporate value. Evaluation and review procedures for executive managers' performance should be established.

7.13. Schemes under which executive managers are remunerated in shares, share options or any other right to acquire shares should be subject to prior shareholder approval by way of a resolution at the annual general meeting. The approval should relate to the scheme itself and not to the grant to individuals of share-based benefits under the scheme.

Guideline — As a rule, shares should not vest and options should not be exercisable within less than three years.

7.14. At least once a year, the remuneration committee should discuss with the CEO both the operation and performance of executive management. The CEO should not be present at the discussion of his or her own evaluation. The evaluation criteria should be clearly specified.

7.15. In the CG Chapter of the annual report, the company should disclose, on an individual basis, the amount of the remuneration and other benefits granted directly or indirectly to the CEO, by the company or any other undertaking belonging to the same group. This information should be disclosed with a split between:

- basic remuneration;
- variable remuneration: any incentive relating to the financial reported year;
- other components of the remuneration, such as cost of pension, insurance coverage, monetary value of other fringe benefits, with an explanation and, if appropriate, the amounts of the main components.

7.16. In the CG Chapter of the annual report, the company should disclose, on a global basis, the amount of the remuneration and other benefits granted directly or indirectly to the other members of executive management, by the company or any other undertaking belonging to the same group. This information should be disclosed with a split between:

- basic remuneration;
- variable remuneration: any incentive relating to the financial reported year;
- other components of the remuneration, such as cost of pension, insurance coverage, monetary value of other fringe benefits, with an explanation and, if appropriate, the amounts of the main components.

7.17. For the CEO and the other executive managers, the CG Chapter of the annual report should disclose, on an individual basis, the number and key features of shares, share options or any other right to acquire shares, granted during the year.

7.18. The company should disclose in the CG Chapter of the annual report the main contractual terms of hiring and termination arrangements with executive managers.

Guideline — Compensation commitments in the event of early termination should be carefully considered. The aim should be to avoid rewarding poor performance.

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PRINCIPLE 8. THE COMPANY SHALL RESPECT THE RIGHTS OF ALL SHAREHOLDERS AND ENCOURAGE THEIR PARTICIPATION

Shareholders' information

8.1. The company should treat all shareholders equally. It should ensure that all necessary facilities and information to enable shareholders to exercise their rights are available.

Guideline The company should enter into a dialogue with shareholders based on the mutual understanding of objectives and concerns.

8.2. The company should dedicate a specific section of its website to describing the shareholders' rights to participate and vote at the general shareholders' meeting. This section should also contain a timetable on periodic information and shareholders' meetings.

8.3. The articles of association and the CG Charter should be available at any time.

8.4. The company should disclose in its CG Charter its shareholding and control structure and any cross-shareholdings exceeding 5% of the shareholdings or voting rights, insofar as it is aware of them, and as soon as it has received the relevant information.

8.5. The company should disclose in its CG Charter the identity of its major shareholders, with a description of their voting rights and special control rights, and, if they act in concert, a description of the key elements of existing shareholders' agreements. The company should also disclose other direct and indirect relationships between the company and major shareholders.

Shareholders' meetings

8.6. The shareholders' meeting should be used to communicate with shareholders and to encourage their participation. Those shareholders who are not present should be able to vote in absentia, such as by proxy voting.

Guideline The company could in this respect also take into account the specificities of the exercise of rights by non-resident shareholders. Within the given existing framework, the company should consider whether modern technology could offer solutions to some practical issues and whether an appropriate approach could be developed in this respect.

Guideline Alone or together with other listed companies, the company should discuss with financial intermediaries methods of increasing participation at the general shareholders' meeting.

8.7. The company should make the relevant information accessible through electronic means in advance of general meetings.

8.8. When convening meetings, the company should provide appropriate explanations on agenda items and on resolutions put forward by the board. In addition to the formalities imposed by the Code on Companies in this respect, the company should use its website to make public all relevant information and documentation on the exercise of the shareholders' voting rights.

8.9. The level of shareholding for the submission of proposals by a shareholder to the general shareholders' meeting should not exceed 5% of the share capital.

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8.10. The chairman should take the necessary measures for relevant questions from shareholders to be answered. At the general meeting, the directors should answer questions put to them by the shareholders on their annual report or on the items on the agenda.

> Guideline Under the guidance of the chairman of the board, directors should answer such questions, insofar as the answers would not cause a material prejudice to the company, its shareholders or its employees.

8.11. The company should post the results of votes and the minutes of the general meeting on its website as soon as possible after the meeting.

Companies with one or more controlling shareholder(s)

8.12. For companies with one or more controlling shareholder(s), the board should endeavour to have the controlling shareholders make a considered use of their position and respect the rights and interests of minority shareholders.

Investors

8.13. Given the reliance on market monitoring to enforce the flexible 'comply or explain' approach of this Code, the board should encourage investors, and in particular institutional investors, to play an important role in carefully evaluating a company's corporate governance. The board should endeavour to have institutional and other investors give weight to all relevant factors drawn to their attention.

> Guideline The chairman should ask institutional investors explanations on their voting behaviour.

8.14. The board should endeavour to have investors carefully consider explanations given for departure from this Code and have them be able to make reasoned judgements in each case. The board should engage in a dialogue with investors if those investors do not accept the company's position, bearing in mind in particular the company's size and complexity and the nature of the risks and challenges it faces.

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PRINCIPLE 9. THE COMPANY SHALL ENSURE ADEQUATE DISCLOSURE OF ITS CORPORATE GOVERNANCE

9.1. The company should establish a CG Charter describing all the main aspects of its corporate governance policy, including at least the elements listed in the provisions of Appendix F.

9.2. The company should state in its CG Charter that it follows the Corporate Governance Principles laid down in this Code.

9.3. The CG Charter should be updated as often as needed to reflect the company's corporate governance at any time. It should be available on the company's website specifying the date of the most recent update.

9.4. The company should establish a CG Chapter in its annual report describing all relevant corporate governance events that took place during the year under review. That document should include at least the elements listed in the provisions of Appendix F. If the company does not fully comply with one or more provisions of this Code, it should explain why in the CG Chapter of its annual report.

9.5. Whenever a price sensitive information or information relating to changes in the shareholders' rights occur in relation to corporate governance, the company should disclose it immediately.

Guideline Price sensitive information or information relating to changes in the shareholders' rights must be understood within the meaning of Article 6, §1 of the Royal Decree of 31 March 2003 on the obligations of issuers of financial instruments admitted to trading on a Belgian regulated market.

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APPENDIX A. CRITERIA OF INDEPENDENCE

2.3./1. The assessment of independence should be made taking into account the following criteria:

- not being an executive or managing director of the company or an associated company, and not having been in such a position for the previous three years;

- not being an employee of the company or an associated company, and not having been in such a position for the previous three years;

- not receiving, or having received, significant additional remuneration from the company or an associated company apart from a fee received as non-executive director;

- not being a controlling shareholder or a shareholder with a shareholding of more than 10%, or a director or executive officer of such a shareholder;

- not having, or having had within the last year, a significant business relationship with the company or an associated company, either directly or as a partner, shareholder, director or senior employee of a body that has such a relationship;

- not being or having been within the last three years, a partner or employee of the current or former external auditor of the company or an associated company;

- not being an executive or managing director of another company in which an executive or managing director of the company is a non-executive or managing director, and not having other significant links with executive directors of the company through involvement in other companies or bodies;

- not having served on the board as a non-executive director for more than three terms.

- not being a close family member of an executive or managing director or of persons in the situations described above.

2.3./2. Whenever legally required the Company should apply the criteria laid down in Article 524 of the Code on Companies.

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APPENDIX B. TRANSACTIONS IN SHARES AND COMPLIANCE WITH DIRECTIVE 2003/6/EC ON INSIDER DEALING AND MARKET MANIPULATION (MARKET ABUSE)

3.7./1. The board shall draw up a set of rules (the "rules") regulating the declaration and conduct obligations regarding transactions in shares or other financial instruments of the company (the "company stock") carried out by directors and other designated persons for their own account. The rules should specify which information regarding those transactions should be disclosed to the market.

Guideline The rules shall set limitations on the carrying out of transactions in the company stock for a designated period preceding the announcement of its financial results ("closed periods") or in any other period considered sensitive ("prohibited periods").

Guideline The board shall make sure that a compliance officer is designated, who will have the duties and responsibilities assigned by the rules. The compliance officer shall inter alia monitor the directors' and other designated persons' compliance with the rules.

Guideline The rules shall provide that before any transaction in the company stock, a director shall inform the compliance officer about the transaction he or she intends to carry out.

Guideline If the board member carries out a transaction in company stock and the compliance officer has been informed, the transaction shall be made public according to the rules.

3.7./2. The board should also designate the other persons to whom these rules will apply.

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APPENDIX C. AUDIT COMMITTEE

5.2./1. The board should set up an audit committee composed exclusively of non-executive directors. At least a majority of its members should be independent. The chairman of the board should not chair the audit committee. The board should satisfy itself that the committee has sufficient relevant expertise to fulfil its role effectively, notably in financial matters.

5.2./2. The board should determine the role of the audit committee. The audit committee should report regularly to the board on the exercise of its duties, identifying any matters in respect of which it considers that action or improvement is needed, and making recommendations as to the steps to be taken.

5.2./3. Parent companies should ensure that the audit review and the reporting on that review cover the group as a whole.

Financial reporting

5.2./4. The audit committee should monitor the integrity of the financial information provided by the company, in particular by reviewing the relevance and consistency of the accounting standards used by the company and its group. This includes the criteria for the consolidation of the accounts of companies in the group.

This review involves assessing the correctness, completeness and consistency of financial information.

The review should cover periodic information before it is made public. It should be based on an audit programme adopted by the committee.

5.2./5. Management should inform the audit committee of the methods used to account for significant and unusual transactions where the accounting treatment may be open to different approaches. In this respect, particular attention should be paid to both the existence of, and the justification for, any activity carried out by the company in offshore centres and/or through special purpose vehicles.

5.2./6. The committee should discuss significant financial reporting issues with both executive management and the external auditor.

Internal controls and risk management

5.2./7. At least once a year, the audit committee should review the internal control and risk management systems set up by executive management, with a view to ensuring that the main risks (including those relating to compliance with existing legislation and regulations) are properly identified, managed and disclosed.

5.2./8. The audit committee should review the statements included in the annual report on internal control and risk management.

5.2./9. The audit committee should review the specific arrangements made, by which staff of the company may, in confidence, raise concerns about possible improprieties in financial reporting or other matters. If deemed necessary, arrangements should be made for proportionate and independent investigation of such matters, for appropriate follow-up action and arrangements whereby staff can inform the chairman of the audit committee directly.

Internal audit process

5.2./10. An independent internal audit function should be established, with resources and skills adapted to the company's nature, size and complexity. If the company does not have an internal audit function, the need for one should be reviewed at least annually.

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5.2./11. The audit committee should review the internal auditor's work programme, having regard to the complementary roles of the internal and external audit functions. It should receive internal audit reports or a periodic summary thereof.

5.2./12. The audit committee should review the effectiveness of the internal audit. In particular, it should make recommendations on the selection, appointment, reappointment and removal of the head of internal audit and on the budget allocated to internal audit, and should monitor the responsiveness of management to the committee's findings and recommendations.

External audit process

5.2./13. The audit committee should make recommendations to the board on the selection, appointment and reappointment of the external auditor and the terms of his or her engagement. In accordance with the Code on Companies, this proposal should be submitted to the shareholders for approval.

5.2./14. The audit committee should monitor the external auditor's independence, in particular in view of the provisions of the Code on Companies and the Royal Decree of 4 April 2003. The committee should obtain a report from the external auditor describing all relationships between the independent auditor and the company and its group.

5.2./15. The audit committee should also keep the nature and extent of non-audit services under review. The committee should set and apply a formal policy specifying the types of non-audit services a) excluded, b) permissible after review by the committee, and c) permissible without referral to the committee, taking into account the specific requirements under the Code on Companies.

5.2./16. The audit committee should be informed of the external auditor's work programme. The committee should obtain timely information about any issues arising from the audit.

5.2./17. The audit committee should review the effectiveness of the external audit process, and the responsiveness of management to the recommendations made in the external auditor's management letter.

5.2./18. The audit committee should investigate the issues giving rise to the resignation of the external auditor, and should make recommendations as to any required action.

Operation of the audit committee

5.2./19. The audit committee should meet at least three times a year. It should review annually its terms of reference and its own effectiveness and recommend any necessary changes to the board.

5.2./20. At least twice a year, the audit committee should meet the external and internal auditors, to discuss matters relating to its terms of reference and any issues arising from the audit process.

5.2./21. The audit committee should decide whether, and if so, when the CEO, the chief financial officer (or senior employees responsible for finance, accounting, and treasury matters), the internal auditor and the external auditor should attend its meetings. The committee should be entitled to meet with any relevant person without any executive manager present.

5.2./22. In addition to maintaining an effective working relationship with management, the internal and external auditors should be guaranteed free access to the board. To this effect, the audit committee should act as the principal contact point for the internal and external auditors. The external auditor and the head of the internal audit should have direct and unrestricted access to the chairman of the audit committee and the chairman of the board.

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APPENDIX D. NOMINATION COMMITTEE

5.3./1. The board should set up a nomination committee composed of a majority of independent non-executive directors.

5.3./2. The chairman of the board or another non-executive director should chair the committee.

5.3./3. The chairman of the board can be involved but should not chair the nomination committee when dealing with the designation of his or her successor.

5.3./4. The nomination committee should make recommendations to the board with regard to the appointment of directors.

Guideline The role of the nomination committee should be to ensure that the appointment and re-election process is organised objectively and professionally.

Guideline More specifically, the nomination committee should:

- draft appointment procedures for board members;
- periodically assess the size and composition of the board and make recommendations to the board with regard to any changes;
- identify and nominate, for the approval of the board, candidates to fill vacancies as they arise;
- advise on proposals for appointment originating from shareholders;
- properly consider issues related to succession planning.

5.3./5. The nomination committee should consider proposals made by relevant parties, including management and shareholders. In particular, the CEO should be entitled to submit proposals to, and adequately consulted by the nomination committee, especially when dealing with issues related to executive directors or executive management.

5.3./6. The nomination committee should meet at least twice a year and every time it deems necessary to carry out its duties.

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APPENDIX E. REMUNERATION COMMITTEE

5.4./1. The board should set up a remuneration committee composed exclusively of non-executive directors. At least a majority of its members should be independent. The chairman or another non-executive director should chair the committee.

5.4./2. The CEO should participate to the meetings in the remuneration committee when it deals with the remuneration of other executive managers.

5.4./3. The remuneration committee should make proposals to the board on the remuneration policy for non-executive directors and the resulting proposals to be submitted to the shareholders, and the remuneration policy for executive management.

5.4./4. The remuneration policy for executive management should include at least:

- the main contractual terms including the main characteristics of pension schemes and termination arrangements;
- the key elements for determining the remuneration, including
    - the relative importance of each component of the remuneration;
    - the performance criteria chosen for the variable elements;
    - the fringe benefits.

5.4./5. The remuneration committee should make recommendations on individual remuneration of directors and executive managers, including on bonuses and long-term incentives, whether stock-related or not, in the form of stock options or other financial instruments.

5.4./6. The remuneration committee should meet at least twice a year and every time it deems necessary to carry out its duties.

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APPENDIX F. DISCLOSURE REQUIREMENTS

[Numbers between brackets are references to the provisions of the Code.]

The CG Charter

9.1./1. The CG Charter should at least include:

- a description of the governance structure of the company, with the terms of reference of the board [1.1.];
- the policy established by the board for transactions and other contractual relationships between the company, including its related companies, and its board members and executive managers, which are not covered by the legal provisions on conflicts of interest [3.6.] [6.7.];
- the measures taken by the company in order to comply with Directive 2003/6/EC on insider dealing and market manipulation (market abuse) [3.7.] [6.8.] ;
- the terms of reference of each committee [5.1.];
- the terms of reference of executive management [6.1.];
- the remuneration policy [7.2.];
- the shareholding and control structure of the company and any cross-shareholdings exceeding 5% of the shareholdings or voting rights, insofar as it is aware of them, and as soon as it has received the relevant information [8.4.];
- the identity of its major shareholders, with a description of their voting rights and special control rights, and, if they act in concert, a description of the key elements of existing shareholders' agreements [8.5.];
- any other direct and indirect relationships between the company and major shareholders [8.5.].

The CG Chapter of the annual report

9.4./1. The CG chapter of the annual report should at least include:

- a list of the members of the board indicating which directors are independent [2.1.] [2.3.];
- a list of the members of the board committees [5.1.] [5.2.] [5.3.] [5.4.];
- a presentation of each new director including a justification when the director is deemed to be independent [2.3.];
- information on directors who have ceased to satisfy the requirements of independence [2.3.];
- an activity report on board and board committees meetings including the number of meetings and the individual attendance record of directors [2.7.];

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- comments on the application of the policy established by the board for transactions and other contractual relationships between the company, including its related companies, and its board members and executive managers, which are not covered by the legal provisions on conflicts of interest [3.6.] [6.7.];

- comments on the application of the measures taken by the company in order to comply with Directive 2003/6/EC on insider dealing and market manipulation (market abuse) [3.7.] [6.8.];

- a list of the members of the executive management [6.2.];

- on an individual basis, the amount of the remuneration and other benefits granted directly or indirectly to non-executive directors, by the company or any other undertaking belonging to the same group [7.5.];

- on an individual basis, the amount of the remuneration and other benefits granted directly or indirectly to the CEO, by the company or any other undertaking belonging to the same group. This information should be disclosed with a split between:
  - basic remuneration;
  - variable remuneration: any incentive relating to the financial reported year;
  - other components of the remuneration, such as cost of pension, insurance coverage, monetary value of other fringe benefits, with an explanation and, if appropriate, the amounts of the main components [7.15.];

- on a global basis, the amount of the remuneration and other benefits granted directly or indirectly to the other members of executive management, by the company or any other undertaking belonging to the same group. This information should be disclosed with a split between:
  - basic remuneration;
  - variable remuneration: any incentive relating to the financial reported year;
  - other components of the remuneration, such as cost of pension, insurance coverage, monetary value of other fringe benefits, with an explanation and, if appropriate, the amounts of the main components [7.16.];

- if some members of executive management are also board members, full and detailed information on the amount of the remuneration they receive in such capacity [7.6.];

- for the CEO and the other members of the executive management, on an individual basis, the number and key features of shares, share options or any other right to acquire shares, granted during the year [7.17.];

- the main contractual terms on hiring and termination arrangements for executive managers [7.18.];

- if any, provisions of the Code that were not complied with during the year and explanation of the reasons for non compliance [9.4.]. ■

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COMPOSITION OF THE CORPORATE GOVERNANCE COMMITTEE

The Committee is composed of

President

Maurice Lippens
- o Chairman of the Board, Fortis
- o Director, Total
- o Director, GBL

Members

Olivier Lefebvre
- o Executive Vice-President, Member of the Managing Board, Euronext N.V.

Luc Vansteenkiste
- o Chairman, Federation of Enterprises in Belgium
- o Managing Director, Recticel
- o Chairman, Spector Photo Group

Eddy Wymeersch
- o Chairman, Banking, Finance and Insurance Commission
- o Professor, Law Faculty, Ghent University

Marco Becht
- o Executive Director, European Corporate Governance Institute
- o Professor of Finance and Economics, Ecares, Université Libre de Bruxelles
- o Director, Foundation of Directors

Pierre-Olivier Beckers
- o Managing Director, Chairman of the Executive Committee, Delhaize Group
- o Chairman, International Retail Association
- o Director, Belgian Olympic Interfederal Committee

Didier Bellens
- o President and Chief Executive Officer, Belgacom

Karel Boone
- o Managing Director, Lotus Bakeries
- o Director, UCB
- o Director, AXA Belgium

Daniel Janssen
- o Chairman of the Board, Solvay

Axel Miller
- o Chairman of the Management Committee, Dexia Bank
- o Member of the Management Board, Dexia

Emiel Van Broekhoven
- o Professor, University of Antwerp
- o Chairman, Vlaamse Federatie van Beleggingsclubs en Beleggers vzw

Hugo Vandamme
- o Chairman of the Listed Companies Committee, Federation of Enterprises in Belgium
- o Chairman of the Board, Roularta
- o Deputy-Chairman of the Board, Barco

Lutgart Van den Berghe
- o Executive Director, Belgian Directors' Institute
- o Extraordinary professor Corporate Governance, Ghent University and Vlerick Leuven Gent Management School
- o Member of the Raad van Commissarissen, csn
- o Director, Electrabel and Belgacom

Secretary

Philippe Lambrecht
- o General Secretary, Federation of Enterprises in Belgium

Deputy Secretary

Michel van Pée
- o General Secretary, Fortis

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For the drawing up of the Code, the Committee was assisted by:

Christine Darville, Company Lawyer

Patricia Fosselard, Member of the Brussels' Bar

Tom Baelden, Researcher

Frédéric de Laminne, Director Euronext Brussels

Kristof Macours, Company Lawyer

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THE CORPORATE GOVERNANCE PRINCIPLES

PRINCIPLE 1. THE COMPANY SHALL ADOPT A CLEAR GOVERNANCE STRUCTURE

PRINCIPLE 2. THE COMPANY SHALL HAVE AN EFFECTIVE AND EFFICIENT BOARD TAKING DECISIONS IN THE CORPORATE INTEREST

PRINCIPLE 3. ALL DIRECTORS SHALL DEMONSTRATE INTEGRITY AND COMMITMENT

PRINCIPLE 4. THE COMPANY SHALL HAVE A RIGOROUS AND TRANSPARENT PROCEDURE FOR THE APPOINTMENT AND EVALUATION OF THE BOARD AND ITS MEMBERS

PRINCIPLE 5. THE BOARD SHALL SET UP SPECIALISED COMMITTEES

PRINCIPLE 6. THE COMPANY SHALL DEFINE A CLEAR EXECUTIVE MANAGEMENT STRUCTURE

PRINCIPLE 7. THE COMPANY SHALL REMUNERATE DIRECTORS AND EXECUTIVE MANAGERS FAIRLY AND RESPONSIBLY

PRINCIPLE 8. THE COMPANY SHALL RESPECT THE RIGHTS OF ALL SHAREHOLDERS AND ENCOURAGE THEIR PARTICIPATION

PRINCIPLE 9. THE COMPANY SHALL ENSURE ADEQUATE DISCLOSURE OF ITS CORPORATE GOVERNANCE

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Synthesis of the responses to the Communication of the Commission to the Council and the European Parliament

"Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward" – COM (2003) 284 final of 21 May 2003

A Working Document of DG Internal Market

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NOTE TO THE READER

This report provides an objective presentation of the comments received by the Commission services in response to the Commission Action Plan "Modernisation of company law and enhancing corporate governance in the European Union – a plan to move forward", adopted in May 2003.

This presentation does not reflect any judgement on the part of the Commission services as regards the different comments made in the consultation. This document seeks to provide a synthesis of the basic positions advanced by respondents in respect of the recurrent themes in the feedback to the consultation.

In drawing up this synthesis, the Commission services have been guided not only by the number of proponents expressing a particular point of view, but also by qualitative considerations such as the extent to which the respondents are representative and the arguments advanced by respondents in support of their views. For this reason, the report will not present a systematic statistical/quantitative analysis of the responses provided on each point. It will endeavour to present a qualitative assessment of the responses received and of the main arguments underpinning these responses. What follows should therefore be regarded as a summary of statements volunteered by respondents regarding their perceived priorities in relation to the Action Plan.

Where relevant, the report will include histograms indicating the general feeling of respondents towards some individual initiatives of the Action Plan. These should be treated and considered with due care since they are inevitably the result of subjective interpretation.

Few respondents answered systematically to all the points mentioned in the Commission Action Plan. Instead, responses tended to deal extensively with the issues of greatest concern to them, especially the issues linked to corporate governance.

The report will broadly follow the structure of the Action Plan. It will start with a general presentation of all the replies received. It will then outline the general comments received on the process proposed, the objectives of the Action Plan and the scope of action and timeframe proposed. The core of the synthesis report will then be the responses to the list of initiatives contained in the Action Plan.

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1. INTRODUCTION

The document summarises the responses to the Commission Action Plan "Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward", adopted by the Commission on 21 May 2003. The consultation of interested parties and the provision of a synthesis report fully comply with the Commission's commitment to greater transparency and public consultation.

Box: Core elements of the Commission Action Plan

The Action Plan defines the key policy objectives which should inspire future actions to be taken at European Union level in the areas of corporate governance and company law. It prioritises over the short, medium and long term, the various actions which appear necessary to achieve a modern European regulatory framework. It indicates which type of regulatory instrument should be used, and outlines appropriate timeframe. In developing the Action Plan, the Commission has paid particular attention to the need for any regulatory response at European Union level to respect a number of guiding criteria: the subsidiarity and proportionality principles; the need to be flexible in application, but firm in the principles; and the need to help shape international regulatory developments.

The main objectives pursued by the Action Plan are to strengthen shareholder rights and third party protection, with a proper distinction between categories of companies, and to foster efficiency and competitiveness of business, with special attention to some specific cross-border issues.

The Action Plan is based on a comprehensive set of proposals, grouped under six important chapters: corporate governance, capital maintenance and alteration, groups and pyramids, corporate restructuring and mobility, the European Private Company, cooperatives and other forms of enterprises.

114 contributions were received in response to this Action Plan. Reponses were received from a full cross-section of industry representatives, institutional investors, financial services providers and professional service providers (auditors, accountants or lawyers). Some national administrations also replied to the consultation. There was a wide geographic coverage with respondents from 17 countries including 14 EU Member States and 1 acceding country. A significant number of replies were received from representative organisations at EU level.

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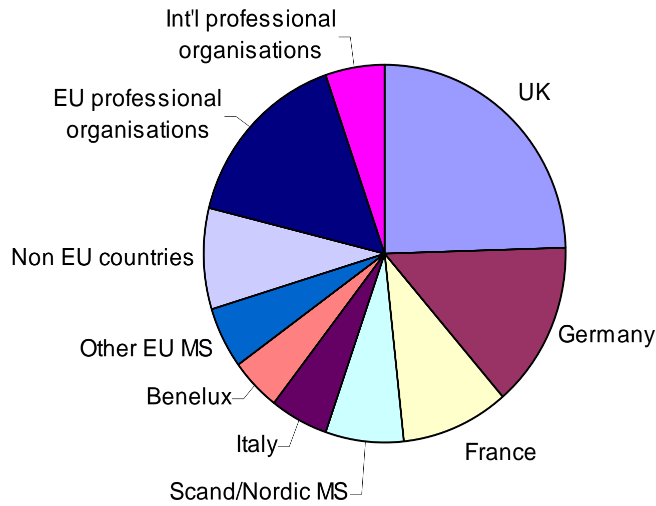

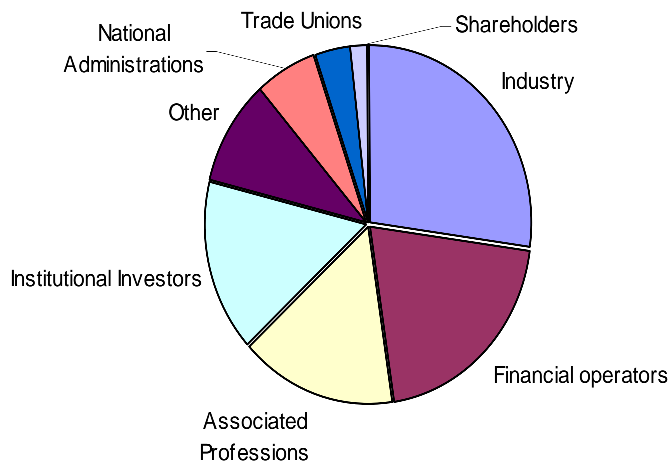

The following broad-brush presentation highlights the main themes which were the object of extensive comments. In addition to some general and recurring messages outlined below, many other valuable insights were gleaned from the submissions. It has proved impossible to document all these in a text of a general nature, but the Commission will ensure that they will be taken into account in its preparatory work on the various initiatives of the Action Plan.

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2. GENERAL REMARKS

2.1. The process

Widespread support was expressed in favour of the Commission initiative to modernize company law and enhance corporate governance. The vast majority of respondents considered this as an essential step to restore confidence in capital markets and the EU economy. The possibility for all interested parties to comment on the content of the Action Plan was also very much welcomed by respondents.

Some respondents highlighted the difficulty to comment on individual measures proposed in the Action Plan given the general wording of the Communication. They therefore considered their contribution as provisional and reserved specific observations to future consultations Some also highlighted the need for further clarification of a significant amount of detail and terminology used in the Plan

2.2. The objectives

The very large majority of respondents welcomed the Action Plan as a major contribution to capital market efficiency and enhanced confidence in the market. The focus recently placed on company law and corporate governance by the Commission was seen as crucial both for restoring trust in capital markets and enhancing the competitiveness of business in the EU.

A few respondents, however, not fully share this view. The following arguments were put forward:

- The objective of simplification and reduction of rules and regulations is not really taken into account in the Action Plan. The latter is likely to lead to considerable addition of rules and recommendations to those already in force. This could be largely detrimental to business confidence;

- Some respondents were of the opinion that the Action Plan should have paid more attention to the interests of other stakeholders in the corporate governance debate. The framework proposed by the Action Plan was viewed by some as considering business only accountable to its shareholders with stakeholders and wider society in general being a secondary consideration. Some also felt that corporate governance could not be separated from corporate social responsibility.

- The Action Plan does not contain enough measures aimed at regulating the activities of the professionals from the financial sector.

Some respondents focused more on the international dimension of the Action Plan. Some highlighted the need for the EU not fall behind in the increasingly globalised business community. A high-level approach, based on framework principles, would be the most effective way to make sure that companies from third countries or accession countries complied with the EU approach on corporate governance, and more generally company law.

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2.3. The scope of EU action

To achieve the objectives pursued (fostering efficiency and competitiveness of business, and strengthening shareholders rights and third parties' protection), the large majority of respondents considered that a fully integrated approach combing self-regulatory market solutions, adequate co-ordination of corporate governance codes and legislation where necessary, was viewed as absolutely necessary. A small number of respondents however stressed that this integrated approach would inevitably be at odds with the prevailing international view, shared by the High Level Group, that a "one size fits all" approach is not appropriate.

Several respondents, however, expressed concerns about the apparent contradiction between the explanatory memorandum which notes the need to avoid over-regulation and the establishment through the Action Plan of an extensive legislative programme, in particular the use of directives in the field of corporate governance. While the need for directives in important company law areas is acknowledged, it was generally recognised that directives are not an appropriate instrument in the corporate governance area because of the lack of flexibility and the risk that these directives could be followed by further overly prescriptive and detailed implementing measures.

Those measures deemed necessary should furthermore be given the appropriate form to ensure effective fulfilment of their respective purpose. A great number of respondents favoured a more extensive use of recommendations, allowing for adjustments to different national legal frameworks, traditions and other special circumstances.

While there was also a wider support for clarifying the rules of governance for listed companies in the first instance, some respondents stressed that applying the same rules to unlisted companies should be carefully considered so that their implementation does not have an adverse impact on competitiveness and freedom of establishment.

Most respondents also agreed with the Commission on the timing envisaged for the realisation of the Action Plan and the degree of priority attached to individual measures. The more detailed comments that follow will, however, highlight some initiatives for which a number of respondents considered that the timing envisaged by the Commission should either be brought forward or postponed. Among the comments made on this point, one can mention the following:

- the timing envisaged was perhaps too ambitious and would not leave enough time for proper consultation of all interested parties;

- the Commission should launch systematic consultation on all the individual proposals of the Action Plan. This consultation should include all those concerned, and not only experts from the business and academic sectors and Member States;

- the main measures of the Plan should be subject to detailed impact analysis as well as an analysis of their inter-dependencies and their relationship to the national legislation. The need to ensure subsidiarity and proportionality of the measures was also mentioned by some respondents.

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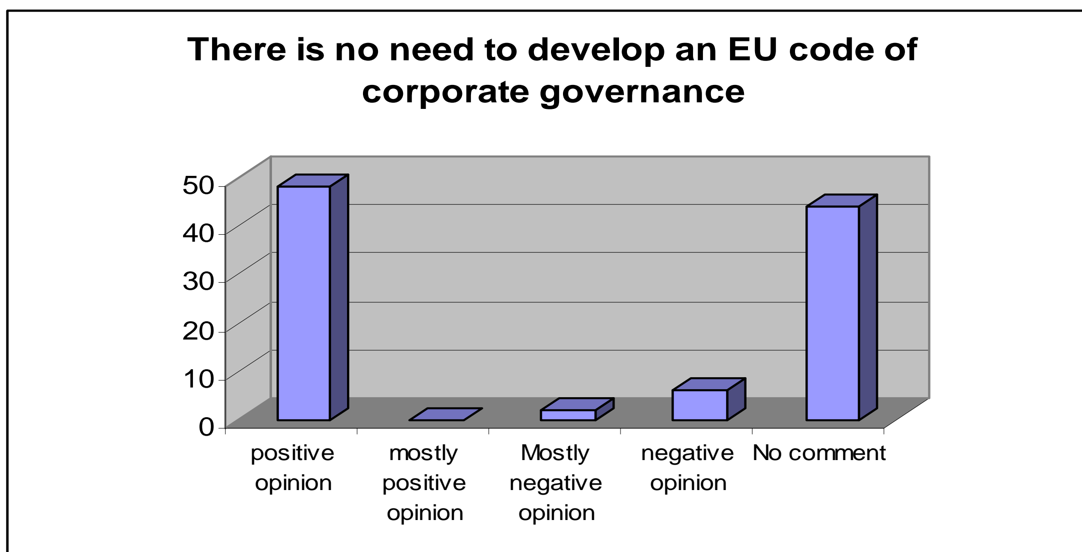
3. CORPORATE GOVERNANCE

The Commission does not believe that a European Corporate Governance Code would offer significant added value but would simply add an additional layer between international principles and national codes.

The very large majority of respondents agreed with the Commission's assessment that there is no need for an EU corporate governance code. The view was generally expressed that corporate governance systems would develop and progress in a natural way under market pressure. The co-existence of different national codes was not perceived by issuers and investors as presenting any major difficulty. The arguments presented by the Commission in the Action Plan were considered as cogent and reasonable and the Commission was invited to follow this line of thinking in its future approach on corporate governance.



A very small number of respondents however disagreed with the Commission's assessment. The arguments put forward were as follows:

- If there is enough convergence between national codes, it should not be difficult to move towards a single code at EU level. An EU code could be particularly helpful for multinationals for which reference to a national code is not appropriate;

- The absence of an EU code could lead to regulatory arbitrage and delocalisation toward Member States with the least constraining code;

- An EU code could be used as a "reference code" where some broad principles and notions could be defined at EU level and applied homogeneously at EU level. This, together with the EU co-ordinating role and use of regulations, would stimulate a further convergence.

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3.1. Enhancing corporate governance disclosure

3.1.1. Annual Corporate Governance Statement

The Action Plan proposed that the Commission should prepare in the short term a proposal for a Directive setting up the main principles applicable to an annual corporate governance statement which should appear prominently in the annual documents published for listed companies.

General agreement was expressed on the principle of enhanced corporate governance disclosure. This is considered as an essential element to improve the transparency of companies and to ensure companies provide investors with better information on the key elements of their governance structure and practices. However, concerns have been expressed about the form that an EU initiative should take. Half of those who commented on this precise aspect expressed their preference for an EU recommendation as an instrument for introducing some disclosure requirements, rather than a Directive. The main reason expressed was that a directive would inevitably result in a high level of prescription which would prevent disclosure evolving through market developments. It was also argued that the process for adopting such a Directive would be too complex and time-consuming, which would not fit with the urgent need to improve company disclosure.

As far as the content of the proposal is concerned, the comments (and sometimes concerns) expressed by the majority of respondents related to three key aspects of the proposal:

- Concern about **duplication of existing requirements** under national legislation, national codes or stock exchange regulations. Some responded that a number of items to be disclosed in the corporate governance statement were already regulated by mandatory requirement in Member States (such as the operation of the shareholders' meeting and its key powers and the description of shareholders' rights). Others also stressed that some of these requirements were already covered by the financial reporting instruments and that the Commission should take account of disclosure requirements set out in International Accounting Standards (IAS). This is especially the case for the direct and indirect relationship between major shareholders and the company.

- Concerns about **the scope of the Corporate Governance Statement**. On the one hand, a number of respondents considered that the non exhaustive list of items proposed by the Commission was already too demanding and related more to matters dealt with under company law (or governed by accounting rules). The statement should therefore focus on pure corporate governance information such as the composition and operation of the board and committees or the reference to a code. On the other hand, a smaller number of respondents suggested additional items to be included in the statement. They concerned, inter alia, details about the directors' nomination process, information of the holdings owned by shareholders exceeding the disclosure threshold, or details on external auditors. Moreover, some of the data proposed for inclusion in the corporate governance statement are received from third persons and can hardly be verified by the company (e.g. information on major holdings which is very difficult to check due to involvement of intermediaries/custodians and information about relationships between shareholders). Therefore asking a company to certify such data might be

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inappropriate. Finally, a number of respondents nevertheless felt that it was difficult to comment on the scope given the very general and sometimes unclear nature of the items mentioned in the disclosure list.

– Concerns about the **inclusion of the Corporate Governance Statement in the annual accounts/reports.** A number of respondents did not support such inclusion as this would make it subject to statutory audit requirement and lead to additional costs for listed companies without generating much added value. It was argued that statutory auditors could only express an opinion on whether the corporate governance statement complied with the respective reporting standards while assessing the adequacy of management was the primary task of those in charge of governance.

But the initiative proposed by the Commission was generally favourably received by the majority of respondents on this point.

3.1.2. Information about the role played by institutional investors

The Commission announced its intention to put forward, in the medium term, a proposal for a directive to oblige institutional investors to disclose their investment policy and their policy with respect to the exercise of voting rights in companies in which they invest, and to disclose to their beneficial holders at their request how these rights have been used in a particular case.

The general feeling was that there is a strong case for institutional investors to play a full and proper role in the companies they invest in and to ensure greater accountability of the institutional investors. But the legislative initiative as proposed in the Action Plan was received much more cautiously by a majority of respondents, not only institutional investors' representatives, but also industry at large.

The request for disclosure of investment policy was received positively by a majority of respondents, since it is already current practice in a number of Member States. However, the comment was made that this should not involve the disclosure of information of a confidential nature.

But a minority of respondents were critical about the two other proposals - to request institutional investors to disclose to their beneficial holders their voting policy and, on request, how voting rights have been used in a particular case. The main arguments put forward can be summarised as follows:

- Some respondents questioned the extent to which such a requirement would enhance institutional investors' participation in the companies in which they invest. They considered the existing rules imposing an obligation on shareholders to deposit their own financial instruments and barriers to cross-border voting as being the main impediments to more active participation by institutional shareholders;

- Some respondents insisted that the policy concerning the exercise of voting rights could not be determined in advance using predetermined or theoretical methods. The policy of voting rights is by its nature very dynamic as it must be able to change very rapidly according to current circumstances;

- Some respondents expressed fears that this could constitute a distortion of competition vis-à-vis non-EU institutional investors;

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- Some respondents also highlighted the difficulties in reconciling such obligations with the principle of equal treatment of shareholders. They considered that institutional investors should not have different rights or obligations compared to other shareholders.

On the other hand, there was a very wide support for the position expressed in the Action Plan that institutional investors should not be required to systematically exercise their voting rights.

Diverging comments were made on both the timing and the form of the legal instrument:

- While the majority of respondents did not express an opinion on the issue of **timing**, some considered the matter as urgent and asked for action in the short term while some felt it deserved more analysis and should be transferred to the list of long-term initiatives. The main reasons behind the latter view are that it is better to wait until an effective system which facilitates cross-border voting and solves problems linked to clearing and settlement is in place before requiring institutional investors to disclose information about voting policy and rights.

- Concerning the **choice of a directive** as the legislative instrument, a number of respondents argued that this area was mainly a matter for national codes and should therefore not be regulated by means of a prescriptive directive. A number considered this should be a matter of recommended good practice rather than of compulsion.

A few respondents (especially from the asset management industry) highlighted the need, when elaborating such a proposal, to take account of the relationship between beneficiaries, institutional shareholders and asset managers and of the role of investment managers to whom decisions on voting are delegated by institutional investors. They also highlighted the need to ensure that there is effective transparency at reasonable cost.

Finally a significant number of respondents noted that the terms "institutional investors" and "beneficial holders" were rather broad and could be easily misinterpreted.

3.2. Strengthening shareholders' rights

3.2.1. Access to information – use of electronic facilities to access relevant information in advance of General Meetings

The Commission considers that the provisions existing in the proposal for a Transparency Directive are a significant and proportionate first step towards ensuring that shareholders are provided with the electronic means to access the relevant information in advance of General Meetings.

Broad support was expressed for encouraging the use of electronic facilities for the receipt and dissemination of information, provided this remained voluntary and best practice, and was not made mandatory. The prevailing feeling was that technological progress could not yet allow the use of electronic means to be made compulsory and that listed companies should be encouraged to offer investors the opportunity to receive communications electronically. At the same time, traditional methods should nevertheless be retained and made freely available.

Any legislation should therefore be enabling in nature and not compulsory as is set out in the proposal for a Directive on Transparency requirements. However, a number of

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participants strongly criticised the approach contained in this proposal whereby a decision by a general meeting to allow use of electronic means has to be supplemented by the individual consent of the shareholder concerned.

The Commission announced its intention to propose further measures in the medium term, if desirable, in the light of the implementation of the Transparency Directive. This was generally welcomed by the small number of respondents that provided feedback on it.

3.2.2. Enhancing other shareholders' rights and solving specific problems linked to cross-border voting

The Commission proposed to come forward, in the short term, with a proposal for a directive setting up a legislative framework aimed at helping shareholders to exercise various rights (for example asking questions, tabling resolutions, voting in absentia and participating in general meetings via electronic means). These facilities should be offered to shareholders across the EU and specific problems relating to cross-border voting should be solved.

A very large majority of respondents on this point supported the proposal of the Action Plan to develop a regulatory framework to encourage the exercise of various shareholders' rights in listed companies and to solve problems related to cross-border voting. This is the legislative proposal that was received most positively by a broad range of respondents. Only a very small number of respondents felt that the European Union should not legislate on the issue of shareholders' rights.

The Commission's attention was nevertheless also focused on the need to draw up balanced implementing measures. As far as voting by proxy is concerned, the company should not be expected to bear the entire administrative burden. Rather; the investor should also be asked to take the necessary steps to vote in absentia or by proxy. Some respondents also noted that the proposal should endeavour to place certain limits on shareholders' rights in order to prevent abuse. This could be done by setting out some conditions, such as on the exercise of the right to table resolutions and to ask questions.

Some concerns were expressed about the proposal to make it compulsory for companies to allow the use of electronic voting, and some felt that the decisions to implement such a means should be left to the discretion of individual companies. Some also highlighted the need for a generalisation of the use of electronic facilities for participation in the general meetings to be abuse-free and to be guaranteed a high standard of security. Some respondents also suggested that such rights, once developed for listed companies, could be introduced as optional for unlisted companies as well.

On cross-border voting, the recommendations made by the "expert group on cross-border voting in Europe" were mentioned as being a good basis for any further EU initiative in this field. A key task in this regard would be to monitor and boost the efficiency of custodians and make sure that each intermediary looked to its accountholder for valid voting instructions. Many respondents felt this was a matter of urgency and supported the Commission proposal to deal with this in the short run.

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3.2.3. Establishing shareholder democracy over the medium to long term

The Commission announced its intention to launch, in the medium term, a study on the consequences of an approach aiming at achieving a full shareholder democracy, at least for listed companies.

The responses on this point did not comment to any significant extent on the proposal to launch a study but focused more on the eventual establishment of a "one share = one vote" principle throughout the European Union. Very diverging views were expressed on the issue. A small majority of respondents on the subject supported the generalisation of the "one share = one vote" principle and urged the Commission to launch its study as a matter of urgency.

A significant minority, however, expressed sometimes serious concerns about the idea and contested the view expressed in the Action Plan that shareholder democracy should be interpreted as "one share = one vote". Some argued that such a principle would run counter to the principle of freedom of organisation and management of companies and would be detrimental to the shareholders' loyalty. While not contesting the idea of launching a study on the consequences of a "one share = one vote" approach, they argued such a study should be launched with a broader perspective and elaborate comprehensively on the question of shareholder democracy. It should also address the issues regarding pyramidal groups, cross shareholdings, golden shares etc..

One respondent representing pan-European views considered it appropriate for the EU to set as a target the enforcement of the "one share = one vote" principle for all newly listed corporations from a certain date (2006 was suggested) and to decide a workable solution for existing listed companies where the principle is currently not enforced.

There was, however, a broad recognition of the difficulties experienced with the issue in the Takeover Bid Directive and the current uncertainty as to whether these would be resolved.

3.3. Modernising the board of directors

3.3.1. Strengthening the role of independent non-executive and supervisory directors

The Commission proposes to adopt in the short term a recommendation aimed at promoting the role of (independent) non-executive or supervisory directors. Minimum standards on the creation, composition and role of the nomination, remuneration and audit committees should be defined at EU level and enforced by Member States, at least on a "comply or explain" basis.

A significant majority of the respondents to this point welcomed the Commission initiative to prepare a recommendation aiming to strengthen the role of independent non-executive and supervisory directors. The presence of independent representatives on the board, capable of challenging the decisions of management was considered by many as a means of protecting the interests of shareholders and, where appropriate, other stakeholders. A small number of respondents however criticised the Commission's intention to adopt a recommendation in this field. They considered board composition to be a corporate governance code issue where "comply or explain" must apply, and expressed reservations about strengthening the role of independent directors any further.

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Many respondents however stressed the difficulty in defining what independence really means, and that in a rapidly evolving global economy, it is impractical to comprehensively list all possible threats to independence. Defining a lengthy set of rules would not necessarily be a solution, since the spirit of these rules could easily be circumvented. A principle based approach was therefore advocated to assess threats and safeguards to independence, as is the case in national law or codes requiring certain directors to be independent.

Many respondents also stressed that while it was indeed important to ensure independence, the involvement of high quality individuals, able to exercise objective judgement, was of greater importance than satisfying detailed rules on independence. Independence requirements should not prevent companies from enrolling non-executive directors of appropriate calibre, and "comply or explain" should be an available solution to any potential impairment of a non-executive director's independence.

The suggestion was also made by some that the supervisory board should publish its reasons for considering a director to be independent in the Corporate Governance Statement in those cases where there is any doubt as to the independence of the individual concerned.

Concerning the proposal to provide non-executive or supervisory directors with the exclusive rights to take decisions in areas where executive directors clearly have a conflict of interest, some respondents highlighted that it was important not to call into question the principle of collective responsibility of decisions taken by the board of directors that exists in some Member States.

A large number of responses also commented on the following issues:

(1) Nomination Committee: A very large majority of respondents suggested that the responsibility for identifying candidates to fill board vacancies should in principle be entrusted to a group composed mainly of independent non-executive directors, as proposed in the recommendation of the High level Group. To do otherwise would undermine the effectiveness of the independent challenge in the boardroom and, as was emphasised by some respondents, would allow executive directive directors to select 'tame' or 'friend of the friend' non-executive directors who would be unlikely to provide the necessary challenge to the executive management. This would have a serious impact on capital market confidence in the business community. The involvement of an independent, objective perspective in board appointments is an integral part of the overall governance "checks and balance" in the company.

(2) Number of mandates that may be held concurrently. Many of the respondents who commented on this point requested that a flexible approach be adopted and that any decision or recommendation should not necessarily stem from a pure numerical reasoning. A one-size-fits-all approach would take little account of the complexity of individual companies and the amount of work required to be undertaken. Some suggested that it would be more practical to introduce the necessary safeguards by requiring directors to disclose the nature and extent of their other commitments and confirm that they will have enough time to perform their duties. As far as the issue of interlocking directorships and the impact on their independence are concerned, some considered that this matter could only be

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dealt with effectively in the framework of national codes, given the large diversity of situations.

(3) Choice between two types of board structures: With regard to the initiative to prepare a proposal for a directive allowing all listed companies to choose between the two types of board structures (monistic/dualistic), a majority of respondents supported the Commission's approach and highlighted the importance of ensuring flexibility for companies in their choice of board structure. Given the significant differences in some cases between Member States' legal regimes, particularly in the area of employee participation, some respondents however argued that it should be left to national legislators to decide whether or not to open national company law to both systems.

A minority of respondents expressed great scepticism as to the benefits such a choice would bring. They argued there was no real demand from companies for such flexibility and that it could result in lengthy and complex company law in each Member State. The point was also made that such a proposal would not pass the subsidiarity test and would complicate and "freeze" the traditional organisational structures in EU Member States.

3.3.2. Directors' remuneration – Adoption of a Commission recommendation

The Commission proposed the adoption, in the short term, of a recommendation fostering an appropriate regime for Directors' remuneration.

While emphasizing that directors' remuneration in the final analysis should be the prerogative of a company and its shareholders, and not government, a large majority of respondents on the issue welcomed the Commission announcement to issue a recommendation in the short term. They consider it as an important principle of shareholder protection that there should be proper recognition in annual accounts of any dilution of share capital. Some considered that this should only be the case for directors of listed companies.

A small number of respondents, however, felt that the remuneration of board members should remain a matter for national laws or corporate governance codes and questioned the need for any intervention at EU level. Some also strongly contested the need for details of remuneration of individual directors to be disclosed, since, they argued, investors need to know the global cost rather than individual remuneration.

With regard to the recognition in the annual accounts of the cost of share options schemes, some highlighted this as a controversial issue on which the International Accounting Standards Board was in the course of developing a new international financial reporting standard.

3.3.3. Enhancing Directors' responsibilities: Confirmation of the collective responsibility of all board members

The Commission proposed to confirm by law at EU level the collective responsibility of board members for financial and key non-financial statements in the short term.

Comments on the need for the EU to develop a regulatory framework in this field were fairly evenly split.

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A majority of respondents supported the principle of the collective responsibility of all board members for financial statements. The comment was made, however, that the responsibility of the supervisory board should not be extended beyond the audited financial statements (and should therefore not apply for instance to quarterly reports). But the divergence in views was more subtle on whether collective responsibility should also apply for key non-financial statements, failing a proper definition of what sort of key non-financial statements this would entail. Some argued it might be impossible to discuss all this information among all members of a board prior to publication. All the information cannot be approved at the same time by all the members of the managing and of the supervisory board, so such proposal was seen as unrealistic and unworkable. But any initiative at EU level should not weaken the responsibility arrangements in individual member States. Minimum standards would therefore be appropriate.

A minority of respondents felt such matters were deeply rooted in the political and cultural background of Member States' legal systems and should therefore be left to national laws or corporate governance codes. Many Member States have equivalent mechanisms in place and it would be difficult to fit an EU concept into Member States legal systems without being able to take each system into account in its entirety. The same respondents argued this was the approach of the proposal for Directive on Transparency requirements which was deemed by a number of them to address the issue of collective responsibility in an appropriate manner. They therefore argued in favour of an in-depth study to assess whether there was a strong case for common EU rules.

Other questions that were put forward included to whom board members should be responsible (any extension of responsibility beyond shareholders was considered unacceptable by some), who would raise respective claims or to whom they would have to be addressed.

3.3.4. Enhancing Directors' responsibilities: introduction of special investigation rights, development of a wrongful trading rule and imposition of directors' disqualification

The Commission announced its intention to come forward in the medium-term with a proposal for a Directive to enhance the responsibilities of Directors.

This initiative was supported by a small majority of respondents but it was made clear that any directive on this matter should give flexibility to Member States as to how such provisions were implemented. An important minority however criticised all these proposals as going much further than the framework rules envisaged by the High Level Group. Although decision-makers in companies should indeed be held liable for their misconduct, company management involves taking risk, which should be allowed for in legislation. The comment was made that such initiatives would belong more to the sphere of insolvency or criminal law and would not fall under company law.

A recurrent comment was that the rules that would eventually be established should be set up in a constructive manner and that all necessary safeguards should be built into the rules in order to prevent disappointed shareholders abusing such rules. It was mentioned that becoming shareholder indeed implies a certain amount of risks and that an investment in a company may suffer from poor performance without any misconduct on the part of directors.

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- As far as the introduction of a special investigation right is concerned, abuses should be avoided by fixing a relatively high percentage of minimum capital and defining strict conditions to exercise this right. Some highlighted that these rights were rarely exercised by shareholders but could still prove a useful safeguard for all those having dealings with companies. It was imperative, however, that these powers should not become a substitute for alternative remedies and that the investigating authority should have the power to decline a request for investigation where sufficient reasons for the investigation were not demonstrated by the applicants. The issue of costs and who should bear them also needed to be addressed in order to avoid abuse.

- With regard to the development of a wrongful trading rule, many considered this was an extremely sensitive issue which should remain a matter for Member States' legal systems. Moreover, some felt that this was not a matter of company law but rather of insolvency law or criminal law. It was also stressed that it is extremely difficult to specify when it is foreseeable that the company is insolvent and cannot continue to pay its debt. Finally, some argued that introduction of a wrongful trading rule might result in some sort of risk aversion for Directors.

- As far as the imposition of directors' disqualifications, it was also met with some scepticism, especially with the competence the European Union might have in this area. Some thought that this would be desirable but might be difficult to apply in practice. The imposition of directors disqualifications is an extremely grave sanction and should therefore be temporary; pronounced by the Judiciary of a Member State; and depend on the commission of a criminal act.

3.4. Co-ordinating corporate governance efforts by setting up a European Corporate Governance Forum

The Commission's proposed to encourage the co-ordination and convergence of national codes through regular high level meetings of a European Corporate Governance Forum which should be set up in the short term. Participants to such a Forum will comprise representatives from Member States, European regulators, issuers and investors, other market participants and academics.

The idea of setting up a Forum was generally welcomed but great concerns were expressed over its mandate and objective. A general request was made to clarify the terms of reference of this Forum further. In this respect, a majority of respondents on this issue commented that if existing EU codes already showed a remarkable degree of convergence, this was mainly due to market pressure. The main task of this Forum should therefore not be to substitute to market forces in fostering further convergence and coordination of national codes but rather to disseminate best practices. Nor should it have any regulatory role or objective to institutionalise convergence of corporate governance.

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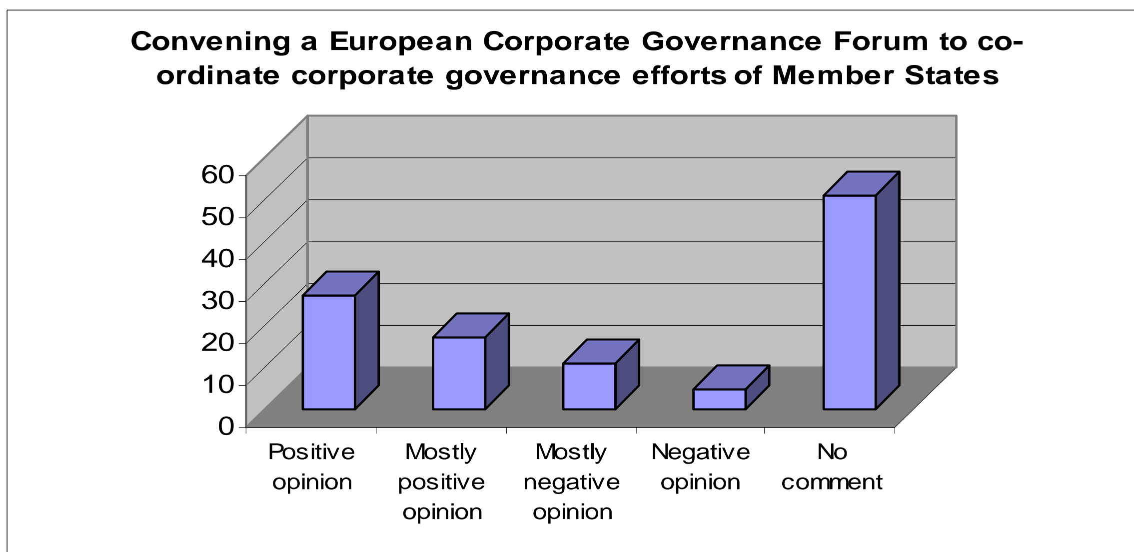

A certain number of respondents also stressed that the Forum should be driven by issuers and investors, not by governments and regulators. Request was also made that all interested parties should be duly represented in the Forum, including all the legal professions involved in Corporate Governance and Company law issues.

The danger of duplication with the large number of bodies and high level Forum that discuss these matters was also mentioned. Ensuring a high level of coordination with these bodies, including the OECD, was therefore requested.

Some respondents, however, considered the establishment of the Forum as a priority since this could prove to be a source of advice for the Commission. The Forum could also play a useful role in assisting new Member States to meet suitable standards in a timely way. The proposal was also made to extend the Forum's mandate to company law issues.

Finally, a number of respondents were concerned by the heavy workload for Commission services and feared this could be detrimental to other priorities. Given the large number of parties involved, the Forum should be given sufficient resources to ensure its capacity to add value.

4. CAPITAL MAINTENANCE AND ALTERATION

4.1. Simplification of the Second Company Law Directive in respect of the formation of public limited liability companies and the maintenance and alteration of their capital.

The Commission intends to adopt in the short term a proposal aiming at simplifying the Second Directive on the basis of the recommendations of the SLIM Group and the proposals of the High Level group.

A very large majority of respondents supported the Commission in considering a rapid modernisation of the Second Company law Directive. Even if particular comments were expressed on some specific points, there was a general agreement that this should be done in line with the SLIM proposals and the recommendations made by the High level Group. However, comments were made on some specific points:

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- Pre-emption rights: a few respondents expressed doubts about the proposal to restrict or withdraw pre-emption rights any further than currently permissible. Pre-emption rights are an asset belonging to shareholders, providing them with the means to protect the value of the capital they provide to business. Disapplying pre-emption rights without safeguards would represent a significant transfer of value away from existing shareholders and would weaken their position. While these respondents agreed it was in the interests of all parties for there to be some limited disapplication of pre-emption rights, there should not be any weakening beyond the current position.

- Financial assistance: some respondents questioned the proposal to relax the prohibition on companies using distributable reserves to provide financial assistance since it was considered that it might disadvantage shareholders.

- Burden of proof : only a few respondents felt that the proposal that creditors should bear the burden of proving that their interests are prejudiced by a capital restructure, results in a failure in the protection of their interests since in their opinion, good governance requires that the obligation to show that the creditors' position is secured should stay with the directors. Failure to protect the interests of creditors would weaken their position, increase risk and thereby raise the cost of borrowing and the cost of capital for companies. On the other hand, there was an opinion that requiring in all cases an enquiry as to creditors' position and creditor objection rights was not appropriate. The court should be able to dispense with an enquiry as to creditors' position (and the consequent publicity requirements and waiting period) if the company seeking to reduce its capital could demonstrate to the court that the creditors are adequately secured. Requiring an enquiry as to creditors' position and creditor objection rights to apply in all cases might lead to creditor hold-ups.

- Acquisition of own shares: some respondents considered that amendments to the present regime on the acquisition of own shares could be of little benefit compared to their disadvantages and should therefore be treated with much care. It was noted that any change in this area should be compatible with the Market Abuse Directive.

- Abandoning an expert valuation for the contributions in kind Some respondents argued that the use of a weighted average market price was subject to certain risks due to narrowness of the market or a limited trade volume, or existing distortions of value both in bull and bear markets. Additionally, it has to be taken into account that in many cases the Stock Exchange price of the stocks invested can be below their real value, which would result in immediate write-offs. Therefore additional protective measures might be necessary through burden of proof rules or enabling the minority shareholders to introduce a motion for an expert valuation.

- Accepting services as contributions in kind: Some respondents stressed that valuation problems had to be solved first. Setting a fixed price might be very difficult, especially for the services provided at the establishment stage when no transparent market exists. A couple of respondents felt that the respective proposal undermined the principle of capital formation and that services provided were "fugitive" and did not represent a part of liability "mass".

4.2. Alternative system:

The Commission announced the launch in the medium-term of a study into the feasibility of an alternative regime to the capital maintenance regime.

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A large number of respondents welcomed the Commission's intention to launch a study into the feasibility of an alternative to the capital maintenance regime. Some respondents, however, urged the Commission to carry out this study in the short term taking into account that companies listed on the EU markets will be required to use IAS in their consolidated financial statements from January 2005. The accounting prescribed for pensions, deferred tax, the cost of share based payments and the impact of fair value measurement for financial instruments would affect the profits available for distribution. The possible result could be to reduce, or even eliminate, dividends being paid by some companies. This unfortunate situation and its possible repercussions on international competitiveness could be avoided if the calculations were based on whether the company had sufficient cash flow to enable it to pay a dividend, whilst maintaining the requisite amount of protection for its creditors.

The principle of launching a study may not have been subject to much criticism, but any idea about the possible introduction of an alternative regime in the second company law directive was forcefully criticised by close to half the respondents on the issue. Some questioned the usefulness of an alternative regime mainly inspired by non-EU jurisdictions. They considered that such a radical change of system regarding statutory capital was not advisable even at a later stage, since it would entail a loss of transparency and a loss of protection for third parties. The alternative introduction of a completely different kind of concept (alongside the existing capital formation and capital maintenance rules) would partly cancel out the harmonisation achieved and replace it with an unwelcome fragmentation of law. A certain level of harmonisation was felt essential.

5. GROUPS AND PYRAMIDS

5.1. Increased disclosure of groups financial and non financial information

The Commission intends to adopt in the short term legislative measures to improve the disclosure of financial and non financial information by groups.

A small majority of respondents on this point agreed with the Commission on the need for additional measures at EU level to improve the financial and non-financial information disclosed by groups when the parent company is not listed. This was seen as an essential part of the strategy to improve disclosure and transparency. The Commission's attention was however drawn to the need to assess carefully the trade-off between the cost and burden for reporting companies and the benefits for the users of such financial statements. Some also highlighted the risk that some additional disclosure could be provided in a very basic form and therefore provide little extra information.

A minority of respondents was much more critical of the Commission's proposal and asked for the issue to be better explained and deeply considered. A first argument advanced by some is that the matter should be left to Member States, since IAS regulations left this issue to Member States' competence in line with the subsidiarity principle. It was mentioned that the financial situation of various parts of the reporting group is already provided by segment reporting under IAS 14 which should be applied by listed entities from 2005. IFRS regulation leaves it to Member States to decide whether to apply the relevant accounting standard also to non-listed companies. A second argument put forward is that the task of consolidated accounts is to present the net assets, financial position and results of the parent enterprise and its consolidated subsidiaries as if they were a single entity. Requiring the disclosure of the effects of

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intra-group transactions on individual enterprises would be inconsistent with that approach. If such information was nevertheless deemed necessary, it would be preferable considering such disclosure in individual financial statements. That would then be an issue for the Fourth Directive

5.2. Implementation of a Group Policy

The Commission intends to come forward in the medium term with a proposal for directive providing for a framework rule for groups allowing the adoption of of a co-ordinated group policy.

A small majority of respondents considered that it would indeed be beneficial to investors and markets as well as to business competitiveness to induce groups to adopt and implement a co-ordinated group policy. The focus of current company legislation was not ideally suited to groups, especially where subsidiaries wee wholly owned and operated as a division of the group rather than as separate companies in their own right. A framework should therefore be developed for groups to allow those responsible for managing a company within the group to implement a co-ordinated group policy, provided that the interests of the company's creditors were protected.

However, a significant minority of respondents criticised the Commission proposal. They felt that a more serious consideration of the need to undertake such an initiative was required. Some proposed that the Commission should undertake a feasibility study as is proposed for the alternative regime to capital maintenance. The main concern expressed was that the introduction of a group policy would be in clear contradiction with the basic principle that every company is, even when belonging to a group, a separate legal entity with its own rights and duties. There is therefore no need to define a rigid and uniform framework for the way enterprises want to organise themselves. This would be in contradiction with the dynamic, flexible framework which companies need.

5.3. Pyramids – Prohibition of stock exchange listing for abusive pyramids

The Commission intends in the medium term to give further consideration to the risk inherent in abusive pyramids and, if necessary, make a legislative proposal to prohibit them from stock exchange listings

A great variety of comments were expressed on the Commission's potential plan to refuse to admit to listing companies belonging to abusive pyramids, after consultation of the Committee of European Securities Regulators.

Quite a number of respondents on this point acknowledged the need for further reflection on the issue of the risk inherent in abusive pyramids for minority shareholder protection. While a number of respondents welcomed the consultation of the CESR, others felt that the opinion of CESR on its own was not sufficient and called for a more in-depth study.

The attention of the Commission was drawn by quite a few respondents to the difficulty of agreeing a clear definition of an abusive pyramid. The definition of abusive pyramids proposed by the High Level Group appeared very broad and might in fact capture perfectly innocent holding companies. It was also noted that pyramids not only improve transparency for financial services group but were sometimes necessary for supervisory reasons for instance for insurance companies. They were therefore necessary and not necessarily abusive.

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Some respondents were more critical and claimed that imposing restrictions on companies' freedom to choose their appropriate structure by denying them access to listed stock exchanges could prove harmful. Since the main problems with pyramid groups seemed to come from a lack of transparency, the investors' risk concerning pyramidal groups could be effectively met by the corresponding transparency requirements in the documents to be published for stock exchange listing.

6. CORPORATE RESTRUCTURING AND MOBILITY

The Commission intends to present in the short term a new proposal for a tenth Company Law Directive on cross-border mergers and a proposal for a Fourteenth Company Law directive on the transfer of seat from one Member State to another. The Commission also considers that the simplification of restructuring transactions pursued by the relaxation of some of the requirements in the Third Directive and the Sixth Directive is desirable in the medium term.

The Commission's intention to present in the short term a new proposal for a tenth Company Law Directive and a proposal for a fourteenth Company Law Directive was supported by a very large majority of respondents. Many highlighted the urgency of coming forward with this long-awaited proposal. In drawing up these proposals, careful consideration would need to be given to the need to ensure there were comprehensive protection rights for members and creditors and to the interaction of the directives with domestic tax law. It should also recognise that rights to shift the seat/place of incorporation of a company can lead to fundamental changes to the rights and obligations on which a range of stakeholders may to date have relied.

A very small number of respondents were more critical about the Commission's intention. Some said that the time was not ripe for such a proposal and that more time was needed to draw the first conclusions from the European Company Statute. Others insisted that more progress needed to be achieved towards taxation and company law harmonisation.

A majority of industry representatives, however, criticised the approach proposed in the Action Plan for solving difficulties relating to employee participation. They opposed the idea that the regime agreed for the European Company Statute should be applied in a somewhat compulsory way in cases of cross-border mergers or transfer of seat, as well as rules that could lead to the import of different systems of employee participation in countries where such a system did not exist. They argued this could act as a disincentive to cross-border mergers and could undermine European companies' competitiveness. As a solution, some respondent recommended that the law of the country in which the merged company was incorporated or to which the seat was transferred should apply.

The request was also made to include investment funds in the scope of the directive so that it could enable fund managers to rationalise their fund rangers and approximate the economies of scale enjoyed by their peers in the US. The difficulty of merging on a cross-border basis was one of the main barriers to a single market for investment funds.

Very few comments were expressed on the proposal to amend the Third and Sixth Company Law Directives. There was a general support for the objective of simplification. Some nevertheless expressed their opposition to the abrogation of the

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provision submitting the merger to the shareholders of the acquiring company for agreement, as it was legitimate that the shareholders were properly informed.

7. THE EUROPEAN PRIVATE COMPANY

> The Commission will launch a feasibility study in the short term with a view to presenting a proposal for an EPC statute in the medium term if the feasibility study confirms the need for such an initiative.

The proposal to launch a feasibility study to evaluate the advantages and problems generated by a possible European legal statute for small and medium-sized enterprises received a very broad support from the respondents. The most important advantage of an EPC was considered to be the incorporation of subsidiaries in different EU Member States under the same conditions, which would create a greater legal certainty for SMEs.

Among the objectives such a study should pursue, the following were mentioned:

– focus on questions concerning the access to this form of company, on the definition of its statute, on the requirement of creditor and employee's protections and on the integration of this form of company law into national legal systems;

– explore the practical problems that could be addressed by the creation of the EPC and alternative means by which these practical issues might be resolved;

– consider any disadvantages that might arise from the creation of a new pan-European vehicle of this nature.

It was felt that issues related to taxation should not be an important part of the study and should remain a matter for national experts. It was highlighted that the study, once completed, should be publicly available.

Some, however, expressed the view that the priority was the adoption of the 10th directive and that the study should only be conducted after its adoption.

8. THE EUROPEAN CO-OPERATIVE SOCIETY AND OTHER EU LEGAL FORMS OF ENTERPRISES

> The Commission intends to actively support the ongoing legislative process engaged on the legislative proposals for these forms of Enterprises. The Commission also intends to launch in the medium term a study aiming at assessing the feasibility of a Statute for European Foundation

Very few respondents commented on the Commission's intention to actively support the ongoing legislative process engaged on the proposed legislation on the statutes of the European Association and European Mutual Society. Some Member States expressed their concerns about these proposed legislation and reserved their comments for the ongoing negotiations on these proposals: they considered this should not be a matter of priority for the Commission. But a majority of the other respondents stressed the importance of finalising these proposals, especially on the Mutual Society. The comment was made that there was an urgent need for work on the Statute of the European Mutual, which stopped in 1996, to resume as soon as possible. Whereas public

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limited companies could develop their activities by choosing the legal form of the European Company, no such option was available for mutual companies, leading to unfair competition between companies of different legal forms.

With regard to the possible development of a proposal on the European Foundation, a few respondents on this point saw no need for further supranational legal forms alongside the European Company. But a majority of respondents considered it appropriate to continue to assess whether the available corporate forms within the EU genuinely meet all the needs of business and other users. It was argued that a European legal form of a foundation would improve the cross-border operations of foundations and their founders, and would provide a new voluntary instrument for cooperation among other types of funders and foundations. It was felt that there was a growing need for a European instrument as the practice of co-funding and transnational activities is beginning to translate into transnational collaborative projects within the EU. The idea of a feasibility study was therefore generally welcomed.

9. ENHANCING THE TRANSPARENCY OF NATIONAL LEGAL FORMS OF ENTERPRISES –

The Commission intends to propose in the medium term a legislative instrument introducing disclosure rules for all legal entities with limited liability, subject to further examination

A very limited number of respondents commented on this point. Globally speaking, the Commission's intention to increase disclosure requirements for all legal entities with limited liability was welcomed. It was considered that some existing legislation in the company law area had a negative impact on the transparency of some enterprises. It was argued, however, that detailed consideration needed to be given to all specific types of limited liability companies across the EU upon which disclosure requirements were not presently imposed, as well as the benefits that might accrue through the imposition of disclosure requirements. Any new disclosure requirement would need to be proportionate.

Three respondents also felt that while subscribing to the objective of enhanced transparency, this should not be used to shift the attention of corporate laws towards fraud or anti-terrorism issues.

10. CONCLUSIONS

DG MARKT services wish to thank all respondents for their valuable and high quality contributions, the details of which may not have been correctly translated in this synthesis document. As announced in the Action, the Commission will give adequate consideration to all contributions when implementing the Action Plan.

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SYNTHESIS OF THE COMMENTS ON THE CONSULTATION DOCUMENT OF THE SERVICES OF THE INTERNAL MARKET DIRECTORATE-GENERAL

"FOSTERING AN APPROPRIATE REGIME FOR SHAREHOLDERS' RIGHTS"

A WORKING DOCUMENT OF DG INTERNAL MARKET

APRIL 2005

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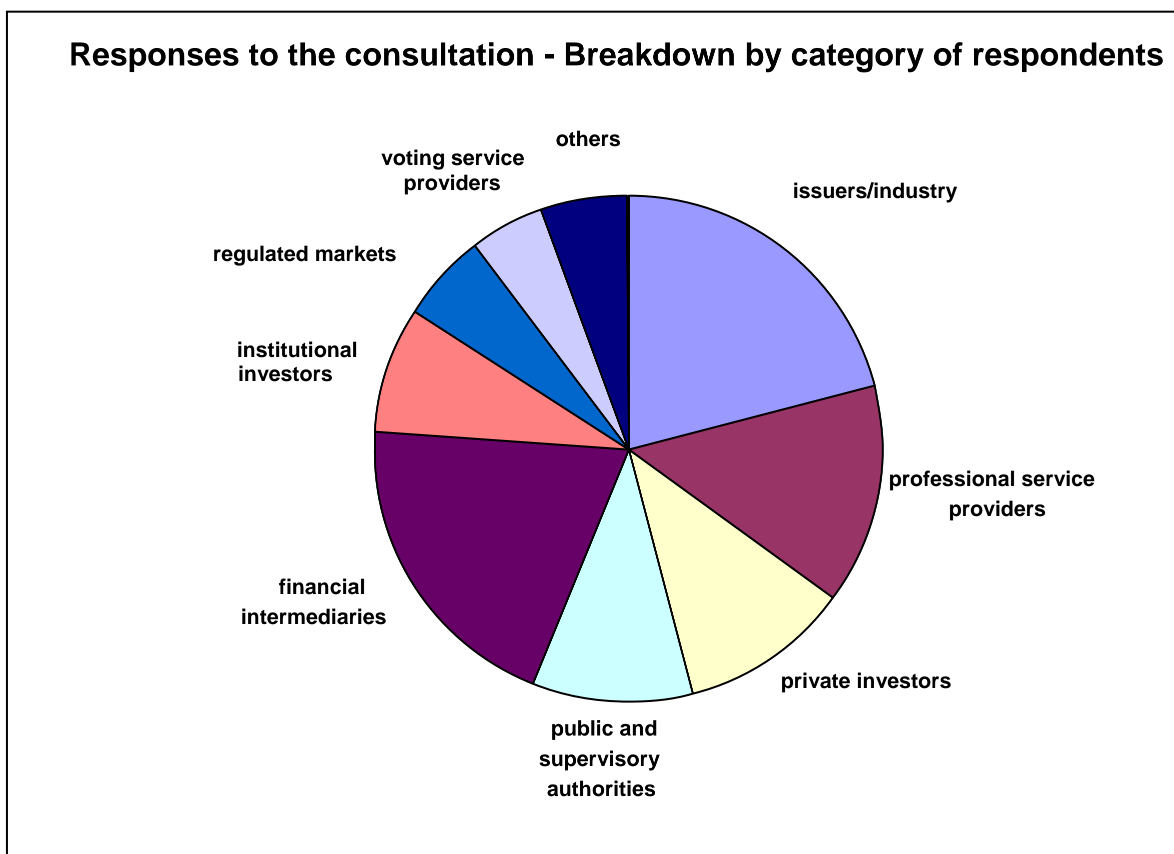
1. Introduction

On 16 September 2004, the Services of the Internal Market Directorate General (hereinafter DG MARKT) launched a public consultation entitled "Fostering an appropriate regime for shareholders' rights" (hereinafter referred to as the "Consultation Document"). The objective of this consultation was to collect the views of interested parties with regard to the feasibility, need and content of possible measures on shareholders' rights. The consultation document focused in particular on the exercise of shareholders' rights in a cross-border context.

A total of 146 contributions were received from a broad range of relevant organisations, parties and professions both interested, and taking part, in the process of the exercise of shareholders' rights in the European Union. Responses were received from issuers and industry representatives, private and institutional investors , regulated markets, financial intermediaries, voting service providers, professional service providers, and public and supervisory authorities.



There was a wide geographical coverage in terms of responses received, with respondents from 20 countries, including 18 EU Member States. A significant number of responses were received from representative organisations at EU and international level.

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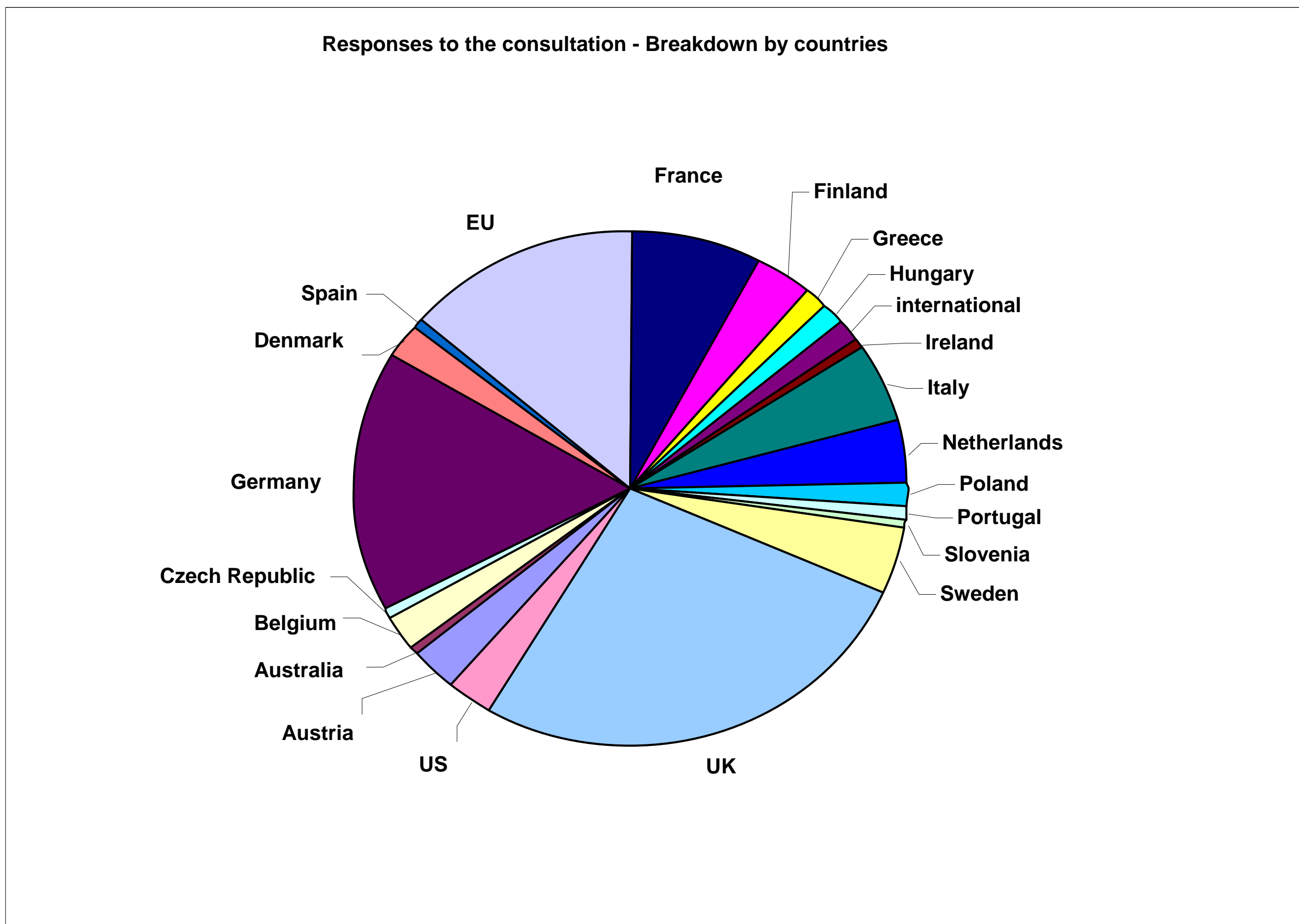

This report seeks to provide a survey of the comments received by the Commission services. It provides a synthesis of the recurrent themes and positions most frequently advanced by respondents with regard to the issues raised in the Consultation Document. It does not reflect any judgement on the part of the Commission services as regards the different comments made in response to the Consultation.

In drawing up this summary, the Commission services have been guided not only by the number of respondents expressing a particular point of view, but also by qualitative considerations such as the extent to which the respondents are representative and the arguments advanced by respondents in support of their views. For this reason, the report does not present a systematic statistical/quantitative analysis of the responses provided on each point. It endeavours to present a qualitative assessment of the responses received and of the main arguments underpinning these responses. What follows, therefore, should be regarded as a summary of statements volunteered by respondents in respect of their perceived priorities on the issues covered in, or relating to, the Consultation Document.

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2. General observations made by respondents

A clear majority of respondents expressed general support for the orientation of the Consultation Document.

General observations made by the respondents mostly focused on the legal form of future measures, if any, and the need to link them with other initiatives at EU and international level in the field of shareholders' rights.

A majority of respondents stated that, should the Commission envisage proposing a directive, any such text should concentrate on high-level principles only and impose minimum standards, rather than attempt to harmonise detailed aspects of Member States' laws. Member States should be given sufficient flexibility with regard to the implementation of such high-level principles and choose the best option for their systems.

While not rejecting legislative action at EU level, some respondents considered that the subjects covered in the Consultation Paper should be better dealt with - in whole or in part – within existing EU instruments, such as the Transparency Directive, the Market Abuse Directive, the Prospectus Directive or the 4th and 7th Company Law Directives, or as part of a possible Clearing and Settlement Framework Directive. These instruments, which already contain some provisions on shareholders' rights (in particular on general meetings and voting, dissemination of information and disclosure of major holdings), should be taken into account, so as to eliminate possible overlapping or excessive regulation, improve coherence and facilitate compliance with EU legislation. Moreover, some respondents considered that any follow-up measures should also take into account the results of the Legal Certainty Project[1] and current works on international projects, such as the Hague[2] and UNIDROIT[3] Conventions, which relate to the rights in respect of securities held with an intermediary.

A number of respondents objected to any prescriptive instrument at EU level and suggested that the subjects covered in the Consultation Document should be addressed in a non-binding EU Recommendation, or through listing rules or best practice codes at a national level.

3. Scope

(Q4) Do interested parties agree that the scope of the forthcoming proposal on shareholders' rights should be restricted to companies whose shares are admitted to trading ('listed companies'), and that Member States could be invited to extend these facilities to non-listed companies?

An overwhelming majority of responses to this question considered that follow-up measures, if any, should apply to all companies whose shares are admitted to trading ('listed companies')[4] because there is a public interest in the governance of companies whose shares are offered to the public. Within this category, a clear majority of respondents agreed that Member States could be invited to extend these facilities also to non-listed companies, where appropriate, in order to protect the interests of the shareholders of such companies.

[1] COM(2004) 312 final

[2] Convention on the laws applicable to certain rights in respect of securities held with an intermediary, 13 December 2002 (Hague Conference on Private International Law)

[3] Preliminary draft convention on harmonised substantive rules regarding securities held with an intermediary, November 2004 (International Institute for the Unification of Private Law)

[4] The words 'listed companies' used here cover the companies whose securities are admitted to trading on a regulated market in one or more Member States within the meaning of Council Directive 2004/39/EC

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However, some respondents argued that follow-up measures, if any, should have a broader scope than that suggested in the Consultation Document. Such measures, in their opinion, should apply to all companies with publicly raised capital, *i.e.*, not only those whose shares are admitted on a regulated market, on the ground that such companies also may have dispersed ownership structures.

A few other respondents suggested that the scope should be narrower than that indicated in the Consultation Document, and should be limited to listed companies above a minimum capital endowment threshold. According to these respondents, imposing new obligations would be too burdensome and costly, especially for small and medium sized listed companies, and might even discourage such companies from going public.

4. Entitlement to control the voting right

4.1 Definition of the 'person entitled to control the voting right'

(Q5.1.1) Do interested parties consider that the forthcoming proposal for a directive should set up a framework to identify the person entitled to control the voting right as the last natural or legal person holding a securities account in the "chain" of intermediaries and who is not a securities intermediary within the European securities holding systems, nor a custodian? Should it also provide for a securities intermediary who is not admitted as a participant in a European securities system but holds shares on behalf of clients to have the possibility to designate his clients in its place as controlling the voting rights? And should it be compelled to designate the identity of its clients at the request of the issuer?

Responses to the consultation show a general consensus among the respondents on the principle that the entitlement to control the voting right should rest with the person having the genuine economic interest in the shares (hereinafter the 'ultimate investor'). However, opinions were mixed with regard to the appropriateness and usefulness of the proposed definition of a person entitled to control the voting right as the 'last natural or legal person holding a securities account in the "chain" of intermediaries and who is not a securities intermediary within the European securities holding systems, nor a custodian'.

A large number of respondents were not favourable to the definition of a 'person entitled to control the voting right' contained in the Consultation Document either because they considered the proposed definition as unsatisfactory (and they then proposed some amendment to the proposed definition) or because they objected in principle to any such definition at EU level.

Within the category of respondents who proposed an alternative definition, several argued that the entitlement to control the voting right should be defined by reference to the entitlement to the share dividends and/or to the proceeds on the sale of shares, rather than by reference to the ranking at the end of the chain of intermediaries. Such respondents considered that the "person entitled to the share dividends and/or to the proceeds on the sale of shares" is more likely to be holding the genuine economic interest in the shares, than the "last natural or legal person holding a securities account in the 'chain' of intermediaries and who is not a securities intermediary within the European securities holding systems, nor a custodian".

The respondents who opposed any such definition at EU level argued that, given the complexity of the cross border voting process, neither the proposed definition, nor any other definition would succeed in identifying with sufficient reliability the person with whom the entitlement to control the voting right should rest, *i.e.*, the ultimate investor. Other respondents felt that the question of who should decide how votes are cast should be left to the contractual relationships between the ultimate investor and the intermediaries in the chain. Issuers should only recognise "shareholders" as entitled to control voting

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rights, *i.e.*, (in the case of registered shares) the person whose name appears on the share register, or (in the case of bearer shares) the person who identifies himself to the issuer as the holder of the shares. Where the person registered as a shareholder, in fact, is the intermediary closest to the issuer, the ultimate investor can ensure via contractual agreements with intermediaries in the chain that the votes are cast according to his wishes.

However, a narrow majority of respondents took the view that a definition of a 'person entitled to control the voting right' is required at EU level. According to these respondents, existing differences between national laws may, in a cross-border context, result in some uncertainty as to who is entitled to vote or in depriving the person with the genuine economic interest in the shares of his/her/its right to vote.

Yet, some of these respondents suggested that the definition contained in the Consultation Document should be improved in one of the following ways:

- In order to ensure that the ultimate investor can actually vote, the definition should refer to a person entitled to 'exercise', rather than 'control', the voting rights.
- The definition should take into account Article 10 of the Transparency Directive, which already identifies some conditions under which the holder of the voting right is not the actual shareholder. Current works on the UNIDROIT and the Hague Conventions should also be taken into account.
- Where intermediaries hold shares on their own account, they should qualify as ultimate investors.
- Collective investment vehicles, investment and pension funds should be considered as ultimate investors and not as intermediaries.
- The definition contained in the Consultation Document uses several terms which have not yet been defined at EU level. In particular, the terms 'intermediary', 'custodian' and 'European securities holding systems' would require defining.

An overwhelming majority of respondents who expressed support for a definition at EU level of the "person entitled to control the voting right", also considered that an intermediary who is not admitted as a participant in a European securities system but holds shares on behalf of clients should have the possibility to designate his clients in its place as controlling the voting rights. However, among these respondents, opinions with regard to an obligation of such intermediary to designate the identity of its clients at the request of the issuer were evenly split.

4.2 Exercise of the voting right

(Q5.1.2) Do interested parties agree with such provisions to allow the ultimate investor to exercise the entitlement to control the voting rights? Do they also agree that the ultimate investor should in all cases be offered the possibility, either to provide the financial intermediary with voting instructions or to be given power of attorney by the same financial intermediary?

A majority of respondents considered that Member States should allow the ultimate investor[5] to exercise voting rights by offering him all options contained in paragraph 5.1.2. of the Consultation Document, i.e., (1) be registered or (2) acknowledged as a shareholder, (3) be given a power of attorney by the intermediary formally entitled to vote, and (4) give voting instructions to that same intermediary. According to these respondents, ultimate investors, ideally, should be offered a variety of possibilities to exercise voting rights, from which they can choose the option that best suits the actual holding structure through which they hold their shares.

[5] defined in the Consultation Document as the "last natural or legal person holding a securities account in the "chain" of intermediaries and who is not a securities intermediary within the European securities holding systems, nor a custodian"

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However, a very high number of respondents took the view that the ultimate investor should, as a minimum, benefit from options 3 and 4, *i.e*., be given a power of attorney by the financial intermediary entitled to vote or provide that intermediary with voting instructions. Member States should leave the availability of options 1 and/or 2 to agreements between interested parties. Some of these respondents, however, urged that future measures, if any, should in no case introduce any obligation on intermediaries to offer proxy voting services. Other respondents requested additional rules on the allocation of the cost of the direct communication between the issuer and the ultimate investor.

Some of the respondents who were not in favour of any provision giving ultimate investors the right to exercise voting rights, pointed out that establishing a direct communication between the issuer and ultimate shareholders would duplicate already existing systems for voting through the chain of intermediaries. This might, as a result, generate legal uncertainty as to who is actually entitled to cast votes. Several respondents objected to option 3 (a power of attorney granted by the intermediary to the investor), since, according to them, voting rights should always emanate from the ultimate investor, who alone should be entitled to give such a power of attorney. This, according to these respondents, was particularly true in bearer share systems, where ultimate investors are acknowledged as shareholders. Some other respondents proposed that option 4 (intermediaries voting upon investors instructions) was ill-suited to their national systems and should be excluded from any future EU measures, if any. This was typically the case of some bearer share systems, which do not give financial intermediaries (which are not shareholders) the right to cast votes on behalf of their clients, as nominees.

4.3 Authentication of the ultimate investor

Q5.1.3(1) Do interested parties agree that securities intermediaries should be required to certify to the issuing company who the ultimate investor entitled to control the voting rights is and for how many shares? What do you think is the best option to allow for such an authentication and certification process? Should the forthcoming proposal address the issue of which parties would have to bear the costs in this authentication?

A clear majority of respondents were favourable to the idea that the issuer should be able to know the identity of ultimate investors and the number of shares in relation to which they control voting rights. This would enable issuers to ensure that only the right persons vote at general meetings and would help avoid double voting. However, some of these respondents argued against any further EU action in this field, on the ground that the obligation to disclose major holdings under Article 9 of the Transparency Directive is sufficient. Other respondents suggested that, should there be any rule requiring certification of who the ultimate investor is and for how many shares, the disclosure of the investor’s identity should only take place either at the investor’s request or subject to his express agreement, in order to protect his privacy.

The respondents who objected to the authentication process stressed that if the voting process at a general meeting should remain democratic, the possibility for the ultimate investor who holds bearer shares to stay anonymous should be preserved. Some other respondents remarked that if an efficient proxy voting system is put in place, there will be no danger of double voting and, therefore, no authentication process will be necessary.

As for the best option to allow for the proposed authentication process, the chain approach was supported by a larger number of respondents than the direct approach, though supporters of either option claimed it was less costly than the other. However, several respondents proposed that rather than prescribe the direct or the chain approach, future measures, if any, should only enable the issuer to rely on the information and

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voting instructions it obtains from the intermediary closest to it. This should be sufficient to avoid potential double voting.

A majority of the respondents considered that the issue of costs should be addressed in a future proposal, if any. However, there was no clear trend with regard to who actually should bear these costs. Some respondents observed that the cost of authentication should not be imposed on issuers since they have no influence on the chain through which the shares are held and, therefore, cannot influence the level of costs involved. Several respondents, however, proposed that the cost of authentication should be divided between the issuer and the investor since both of them have an interest in a seamless voting process.

4.4 Stock lending

(Q5.2(1)) Do interested parties consider that the practice of securities lending create problems for the exercise of voting rights, in particular in a cross-border context that should be tackled at EU level?) Should such provisions essentially aim at enhancing transparency and protecting the interests of long term investors?

According to a majority of respondents, practices of securities lending do not create problems with regard to cross-border voting. Therefore, the terms under which securities are lent should be left to contractual provisions between lenders and borrowers or to codes of best practice, and should not be tackled at EU level.

Responses favourable to some EU initiative in this field pointed out that shareholders often are not aware of the fact that their securities are being lent. Therefore, some of these respondents suggested, there should be minimum transparency requirements at EU level to ensure that shareholders are aware of the consequences of securities lending on voting rights. Other respondents, furthermore, suggested that speculative securities lending operations around the time of general meetings (especially in cases of take-overs) should be prohibited.

4.5 Depositary receipts

(Q5.3) Do interested parties consider that there are problems associated with the holding of depositary rights that should be addressed in the forthcoming proposal for a directive? If so, should it allow holders of depositary receipts to be recognised as holding the rights attached to the underlying shares and that any specific exclusion from voting right should be removed?

A majority took the view that there are problems associated with holding of depositary receipts, which potential new measures, if any, should address. In particular, holders of depositary receipts often do not have the right to vote on the underlying shares. Some respondents suggested that depositary receipts holders should be granted the same rights as the shareholders, or have the possibility either to vote directly or issue voting instructions.

Among the respondents who objected to any EU intervention in this field, a number of respondents pointed out that depositary receipts are traded mainly by professional investors who are aware of all consequences of holding depositary receipts. In their view, therefore, this matter should be left to market forces and contractual arrangements between depository receipts holders and their intermediaries.

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5. Pre-annual general meeting stage

5.1 Communication of information relevant to GMs

(Q6.1(1)) Do interested parties consider that the forthcoming proposal should contain provisions regarding the disclosure of GM notice and materials and some standards for the dissemination of such information? What should be these standards? Should it also require issuers to maintain a specific section on their website where they would have to publish all General Meeting- related information? Should issuers' websites or such GM dedicated sections of their websites contain also a description of shareholders' and investors' rights in relation to voting (voting by proxy or in absentia) and with regard to the GM (right to ask questions or table resolutions)? Do interested parties consider that the forthcoming proposal for a directive should deal with the way information is 'pushed' by the issuer to the ultimate investor? If so, which of the two approaches (chain or direct) is preferable? Should the possibility be given to the ultimate investor to opt out of such identification system?

An overwhelming majority of respondents expressed support for EU minimum standards for the disclosure and dissemination of the GM notice and GM-related materials prior to the GM. Within this category, a large majority of respondents suggested that EU minimum standards should relate both to the content, timing and dissemination methods of both GM notices and other GM-related materials.

Respondents who objected to EU minimum standards often considered that the topic is sufficiently covered by the Transparency Directive.

With regard to the content of a GM notice, a large number of respondents expressed the view that EU minimum standards should provide that any notice of a GM should contain a mention of the exact date, time, place and agenda of a GM. Some respondents considered that GM notices should also contain a description of all available means of voting or asking questions, the accession code for virtual GM participation, a full list of GM related documents and how and where to obtain these.

A large number of respondents considered that a minimum notice period should be established at EU level. Suggestions ranged between 15 days and 6 weeks before the GM, with a majority of replies supporting a notice period of more or less one month before the GM (e.g. '4 weeks', '20 clear working days', '30 days', etc).

A significant majority of respondents considered that issuers should be required to maintain a specific section on their website, which would contain all GM-related information. The main supporting argument is that the electronic availability of information is cheaper than traditional means of supplying information, and enables a faster access to information. Most of these respondents were also of the opinion that such website section should contain a description of shareholders' (and investors') rights in relation both to voting (voting by proxy or in absentia) and to the general meeting (rights to ask questions or table resolutions).

However, several respondents pointed to the additional costs of maintaining websites and suggested, therefore, that any such obligation should be imposed only on those issuers who already use the relevant electronic technology.

A majority of respondents considered that any new measures should deal with the way information is 'pushed' by the issuer to the ultimate investors. However, some other respondents suggested that no obligation should be imposed on issuers to 'push' information to ultimate investors, because this would expose them to excessive costs. Rather, ultimate investors should be 'pulling' the relevant information from issuers' websites.

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A minority of respondents commented on whether information should pass through the chain or be accessible/supplied directly. These respondents generally remarked that this question is related to the issue of the identification of the ultimate shareholder and should be considered in close relation with it. A majority of them considered that investors should have the possibility to opt out of the identification system.

5.2 Share blocking

(Q6.2) Do interested parties consider that share blocking requirements represent a barrier to the exercise of voting rights, especially for cross-border investors? Do interested parties agree that the forthcoming proposal should require the abolition of share blocking requirements and propose an alternative system to determine which shareholders are entitled to participate and vote at the GM?

An overwhelming majority of respondents considered that share blocking requirements represent a barrier to the exercise of voting rights, especially for cross-border investors. In their view, therefore, share blocking requirements should be abolished and replaced by an alternative system. The majority of respondents favoured a record date system as an alternative to share blocking. Few other respondents preferred verification systems, under which holdings are verified during a few days before GMs, during which investors can trade freely until reconciliation between holdings and votes is carried out shortly before the GM. A number of respondents considered that harmonised clearing and settlement dates would be a decisive step, as there would be one single rule determining who and from which point in time one is a shareholder.

As regards the timing of a record date, the majority of respondents considered that record dates should be as close as possible to general meetings, to ensure that voters are still shareholders when the GM takes place. Suggestions with regard to timing ranged from 15 days to 24 hours before a general meeting, with a majority of responses pleading in favour of a record date 3 or 2 days before the general meeting.

6. Shareholders' rights in relation to the GM

6.1 Participation in the GM via electronic means

(Q7.1) Do interested parties consider that Member States should be prevented from imposing requirements on companies regarding the venue of the GM that would act as a barrier to the development of electronic means of participation? Should additional criteria be defined at EU level to enable shareholders participation to the GM by electronic means?

A clear majority of respondents considered that requirements on companies regarding the venue of the GM that would act as a barrier to the development of electronic means of participation should be removed. However, an almost equal majority insisted that any provisions on electronic participation should strictly be of an enabling nature. Companies should have the possibility, but not the obligation, to offer electronic means of participation. 'Actual' general meetings should not be abolished and replaced by 'virtual' meetings. Some of the respondents suggested that future measures, if any, should also contain provisions covering the misuse of the electronic means, double voting, rules on the authentication of shareholders participating by electronic means and on the consequences of possible malfunction of the electronic system.

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6.2 Right to ask questions

(Q 7.2) Do interested parties consider that the forthcoming proposal for a directive should define minimum standards on the way shareholders' questions may be filed and dealt with at the GM? If so what should such minimum standards be?

A clear majority of respondents took the view that there is a need for defining minimum standards on the way shareholders' questions may be filed and dealt with at the GM.

With respect to the minimal standards, the majority of respondents considered that any shareholder should have the right to ask questions at the General Meeting, regardless of the number of shares held. However, the majority of these respondents also felt that the right to ask questions should be carefully monitored, in order to prevent GMs from being overwhelmed by excessive questioning, or abusive or unjustified questions.

A number of suggestions were made with regard to minimum standards. The majority of respondents considered that shareholders should be given the possibility to ask questions both in advance (notably by electronic means) and during the meeting. However, a large number of respondents felt that any possibility given to shareholders to ask questions during the meeting via electronic means may lead to uncontrollable situations and, as a result, would disrupt meetings. According to the majority of respondents, questions asked before or at a GM should relate to the general meeting, though there were calls to allow questions on any topic, provided these are asked in advance. Some respondents argued that the Chairman of the meeting should retain some discretion to refuse or group questions.

With respect to the right to obtain a reply to a submitted question, a number of respondents considered that the right to ask questions only made sense if issuers were obliged to reply to questions. However, there should be a right not to reply when this would cause the issuer serious harm. Issuers, in particular, should be under no obligation to disclose business secrets and should have the right not to answer questions on price sensitive issues. Opinions were mixed as to the way in which replies should be formulated. Several respondents suggested that answers should be either given orally during the GM or published in writing on a dedicated section of the issuer's website or included in the minutes of the GM. According to some respondents, a question should not be admissible in the GM if it (or a similar question) was asked before the meeting and the response to it was published on the issuer's website sufficiently early before the GM.

6.3 Right to add proposals to the agenda and to table resolutions

(Q 7.3) Do interested parties consider that the forthcoming proposal for a directive should define certain criteria concerning the maximum shareholding threshold for the tabling of resolutions and placing items on the GM agenda and the timing to file these ahead of the GM? If so, what should these minimum criteria be?

A clear majority of respondents supported minimum criteria at EU level concerning the maximum shareholding threshold for the tabling of resolutions and placing items on the GM agenda, and the timing to file these ahead of the GM.

A clear trend emerged in favour of subjecting the right to table resolutions and to place items on the agenda to the holding of a minimum shareholding expressed as a percentage of the share capital. Percentages ranged from 1% to 10% of the share capital, with a prevalent trend in favour of a 5% threshold. Some respondents also recommended to leave issuers free to lower such threshold, and commented that the threshold would correspond to a very different economic reality depending on the size

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of companies. Others felt that thresholds should be lowered in relation to the size of the issuer's share capital. Only very few respondents took the view that, in order to promote shareholder democracy, no minimum shareholding threshold should be imposed.

A non-negligible minority of respondents felt that the minimum threshold should correspond to the limits set for squeeze-out rights, *e.g.*, those contained in the Takeover Bids Directive or those suggested by The High Level Group Report. However, some respondents opposed this approach, on the ground that squeeze-out rules vary from one Member State to another and that setting minimum thresholds at such a level would exceedingly reduce the rights of minority shareholders.

With respect to the timing for the filing of resolutions ahead of the GM, it was proposed that deadlines should be fixed sufficiently ahead of the GM in order to give the issuer enough time, as may be reasonable, for amending and circulating relevant GM materials.

6.4 Voting in absentia

(Q7.4) Do interested parties consider that the forthcoming proposal should oblige Member States to introduce in their national company law the possibility for all companies to offer shareholders the option of voting in absentia (by post, electronic or other means)? Do interested parties consider that the forthcoming proposal should contain provisions to further facilitate the use of proxy voting across Member States and to lift obstructive local requirements? If so, what should be the minimum criteria that should be defined at EU level, taking into account the constraints of cross-border voting?

An overwhelming majority of respondents considered that Member States should be obliged to introduce in their national company laws the possibility for all companies to offer shareholders the option of voting in absentia. Within this category, a large number of respondents expressed their support for enabling electronic voting, voting by post, and rules facilitating proxy voting.

Several respondents suggested that voting by post should always be available; else, shareholders without access to electronic means of communication might be discouraged from voting or would be in a less favourable position than other shareholders. On the other hand, several other respondents who objected to voting by post argued that such means of voting do not allow shareholders to react to the latest developments at the general meeting and are too costly.

An overwhelming majority of respondents considered that the use of proxy voting should be further facilitated across Member States and existing obstructive local requirements should be lifted. The process for appointing proxies and the acceptance of proxies by issuers should be simple, and exempt from unnecessary administrative burdens. In particular, restrictions on the persons who may be appointed as proxies should be removed. Further, both the electronic appointment of proxies and electronic proxy voting (with electronic signature) should be made available. Any provisions that might be envisaged at EU level should also contain minimum criteria on the validity period for proxies. Some of the respondents added that minimum standards with regard to the verification of proxies and the identification of proxy holders would be welcome in order to ensure that only duly authorized proxies attend GMs and vote. These standards could be embodied in minimum requirements for the content of proxy forms.

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7. Post-GM information

7.1 Dissemination of GM results and minutes

(Q8.1) Do interested parties consider that companies should be obliged to disseminate the results of votes and minutes of the GM to all shareholders and/or to post these on their website within a certain period following the meeting?

A majority of respondents considered that issuers should be obliged to disseminate the results of votes and minutes of the GM to all shareholders and/or to post them on their website within a certain period following the GM. A substantial proportion of respondents suggested that such publication should take place in addition to the dissemination of the information to all shareholders. However, numerous respondents considered that, for cost reasons, hard copies should only be sent to those shareholders who specifically requested them. The suggestion was also made that results of votes and minutes of the GM should be published in company registries or on the websites of stock exchanges where issuers' shares are traded.

Opinions differed largely on the maximum period of time within which the issuer should make GM results available, ranging from immediately after the GM to 3 months after the GM.

As for the kind of post-GM related information published on the issuer's website, the respondents considered that both voting results and GM minutes should be published. There were some calls for excluding GM-related questions and their answers from the scope of such website publication for reasons of confidentiality.

7.2 Confirmation of vote execution

(Q8.2) Do interested parties consider that the non-confirmation of vote execution hinders significantly the exercise of their voting rights? If so, do they consider the forthcoming proposal should address the issue by defining obligations on issuers and securities intermediaries to provide and pass automatic confirmation of vote execution along the chain from the issuer to the ultimate investor?

Among the respondents who commented on this section, there was no clear trend as to whether the non-confirmation of vote execution significantly hinders the exercise of voting rights. Similarly, there was no strong support for defining obligations on issuers and securities intermediaries to provide and pass automatic confirmation of vote execution along the chain from the issuer to the ultimate investor. Several respondents, however, commented that, such a rule, if any, should apply only to the intermediaries in the chain and not to issuers, which are already overburdened with other obligations.

Those who objected to any EU action on this field mainly pointed out that the confirmation of vote execution is primarily a matter for the relationship between the shareholder and the proxy/intermediary and should be left to contractual arrangements between those parties. Moreover, the obligation to confirm vote execution would cause significant costs, which would not be offset by appropriate corresponding benefits.

Support for an obligation to confirm vote execution was mainly limited to automatic vote confirmation in cases of electronic voting, on the ground that this would not generate high costs, unlike paper-based confirmation. Cost considerations also led several other respondents to suggest that the confirmation of

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vote execution should be provided only upon the request of ultimate investors. Others suggested that confirmation of vote execution should be provided confirmation to institutional shareholders only.

8. Additional Issues

A large number of respondents identified additional issues which, in their view, are important for enhancing shareholders' rights across the EU and, therefore, should be considered as part of any follow-up measures. The main recurrent themes can be summarized as follows:

In order to further facilitate access to information about GMs, GM-related information should also be published on a central database or in an official bulletin maintained either at national or EU level.

Pre-GM communications should be done in the issuer's local language and in English.

Shareholders should have the right to communicate among themselves. They should be free to exchange information and institutional shareholders, as long as they do not seek to obtain control, should be allowed to discuss voting items and vote together on any particular resolution.

Quorums, as prerequisites for holding valid GMs, should be reduced or abolished.

The "one share - one vote" principle should be addressed.

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AFEP - AGREF

«Promoting Better Corporate Governance In Listed Companies»

Report of working group chaired by Daniel Bouton,
President of Société Générale Bank

Press Conference
23th Monday September 2002

INTRODUCTION

The market economy, based on the free confrontation of supply and demand and, internationally, on freedom of trade, has demonstrated its superiority compared with any other form of economic organization. It must include as a corollary a set of effective

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regulating mechanisms, as there can be no free-market system without an underpinning of trust in the rule of law.

Such a system cannot tolerate fraud. If fraudulent acts are committed, they must be punished. Most legal systems provide for severe criminal penalties for such acts, and these should be fully applied. French law is particularly well armed in this area, with criminal offences having been created to deal with such abuses as misappropriation of corporate assets, filing of fraudulent financial statements or spreading of false information. However, it would plainly be illusory to imagine that increasing the number or severity of criminal sanctions can offer effective protection against the main risks, which lie in strategic errors or incompetent management.

Such risks cannot be eliminated by any regulatory system, however optimal. It is nevertheless crucial that the rules and practices in place limit such risks and promote ethical behavior on the part of market players. Restoring trust therefore involves making sure that the system includes sufficiently clear and appropriate rules, and ensuring that these rules are fully and effectively implemented. In addition to the moral imperative, this represents a key economic requirement for all developed economies, taken both collectively and individually. Ever more initiatives are being launched in both the United States and Europe, as each country understands that what is at stake is the competitiveness of its businesses and of its financial markets.

Recent events, particularly revelations of questionable accounting practices, have impacted global companies, ruined shareholders and employees, and led to the disappearance of one of the leading audit firms. This has caused a severe breakdown of trust in the very essence of a market economy, namely the quality of corporate governance and the reliability of financial statements. The latter provide the link between the economic reality of each company and its shareholders, both institutional and individual.

In terms of management practices, legislation, some tax or market regulations, accounting standards, as well as professional standards in the fields of accountancy, banking or insurance, French companies find themselves in a very different situation from that of their U.S. counterparts. In many respects, French companies are better protected against the risk of excessive or misguided practices.

Nevertheless, in the face of such a widespread breakdown of trust as we are experiencing, French companies cannot be satisfied with the status quo. It has become clear that a certain number of principles need to be reviewed in the areas of corporate governance, financial disclosure and communication, as well as with respect to the adequacy of accounting standards.

Following the publication of the two Viénot reports in July 1995 and July 1999, France now has a very extensive set of rules of corporate governance, promoting both efficiency and transparency. The progress that has been achieved since 1995 is reflected in the content of the annual reports issued by listed companies.

In April 2002, Bertrand Collomb, Chairman of AFEP-AGREF[1], and Ernest-Antoine Seillière, Chairman of MEDEF[1], wished to assess whether there was a satisfactory match

[1] Association Française des Entreprises Privées et Association des Grandes Entreprises Françaises (association of French private-sector companies and association of major French corporations).

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between the expectations of investors and financial markets, on the one hand, and the body of rules, standards and practices in respect of companies, on the other.

The working group that was set up was charged with examining the following questions:

- Improving the workings of company bodies for management or the supervision of management, in particular the audit committee;
- The adequacy of accounting standards and practices;
- The quality of financial information and communication;
- The effectiveness of internal and external controls (by auditors and regulators);
- Relations between companies and the various categories of shareholders;
- The role and independence of various other market players, such as banks, financial analysts, rating agencies, etc.

The task entrusted to the working group could not replace the ongoing role of existing structures that address these questions, therefore the working group drew upon the work of the MEDEF Ethics Committee, chaired by René Barbier de la Serre, as regards the major question of the role and independence of statutory auditors.

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Due to the vast scale of the task entrusted to it and to the urgency of the situation, the working group did not deal in detail with all of the subjects within its remit. As an example, it has not attempted to make any proposals concerning the institutions in charge of regulating financial markets.

With the *Commission des Opérations de Bourse* (COB) and the *Conseil des Marchés Financiers* (CMF), France has respected, competent and independent market authorities. The announced merger between the two bodies can only be greeted with approval, since it should allow a strengthening of the means of investigation and control which are so vital for a regulatory authority.

These market authorities, as well as the supervisory authorities overseeing banks, brokers and other financial intermediaries, are responsible for ensuring that the rules governing the operation of financial markets constantly achieve an appropriate balance between the interests of issuers and those of investors. The rules relative to the independence of analysts from investment banking services as they have just been defined by the CMF are sound and should help protect the market from some of the excesses that have occurred in the United States. Such rules must be strictly enforced.

Listed companies also expect that professionals in the field of financial information and communication should be governed by a strict ethics code, where they do not already have

[1] Mouvement des Entreprises de France (French business confederation).

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one. Such an ethics code needs to be consistent with the immediate and often very powerful impact of their activities, and should be rigorously enforced.

Similarly, the working group did not review the situation of rating agencies, which play a major role in relations between listed companies and the market. In some cases, whether for countries or for companies, their action has appeared to have a triggering or accelerating effect on a financial crisis, whereas ratings are intended to serve only as indicators of possible problems to come.

The three main rating agencies, which are private organizations, are financed by the issuers that they are in charge of rating. Their role today raises a number of questions for which answers could only meaningfully be reached at the international level, whereas all three are U.S. legal entities. In any event, the requirement of transparency should apply to these companies themselves just as to others. They should therefore, at regular intervals, provide the market with an explanation of their policies and any changes in them, and describe the decision-making processes they apply.

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Recent events raise the fundamental issue of the distribution of responsibilities among the various market players, such as executive management, boards of directors, auditors and regulators. These events did not take place in a de-regulated environment. In the United States in particular, businesses are governed by a great many rules and standards, which are extremely detailed and carry the threat of serious penalties for non-compliance.

What is at issue is not so much the letter of the rules as their spirit, not standards but behavior. Though regulation is of course needed, formal rules and superficial compliance with them cannot be enough. What is needed is for all concerned parties to apply, in good faith, a set of "ground rules", the aims of which are understood and accepted by all.

The working group is convinced that the surest way to improve corporate governance is through the evolution of individual and collective behavior following "best practices" based on fundamental principles consistently applied to all economic players: personal responsibility, transparency and integrity.

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FIRST PART

Further Improving Corporate Governance Practices

The working group noted with satisfaction that in the majority of large French companies the recommendations of the Viénot reports were rapidly implemented. There are, however, some major listed companies that still do not satisfy some of the key principles prescribed by those reports. The working group hopes that those recommendations will be implemented in a manner that takes into account the diversity of legal structures that exists among French companies. French law has for many years provided two methods of organizing a corporation (*société anonyme)*, one with a board of directors and the other with a management board and supervisory board.

The law of May 15, 2001 on "new economic regulations" introduced a new choice for companies governed by a board of directors, to separate the functions of chairman of the board and chief executive officer or to keep them joined. French corporations thus have a choice between three possible models of management and control structures, a situation that is unique among comparable countries. This diversity of options should allow the shareholders and management of each listed company to work out the solution that best fits the nature of the company and its circumstances.

One view is that the separation of functions within the board of directors or in the structure of the supervisory board and management board greatly facilitates control over the workings of the company and appraisal of the pre-eminent corporate officer (chief executive officer or chairman of the management board, as the case may be). An alternative view is that the same result can be achieved in a company led by a chairman and CEO thanks to effective specialized committees (audit committee, compensation committee, etc.).

The working group has not resolved this debate, but reaffirms that the key consideration is transparency. This transparency must be present between executive management and the board of directors, as well as between management and the market or shareholders. For shareholders, the general meeting is not only a time when decisions are to be taken, but also when the corporate leadership reports on the company's operations and on the workings of the board of directors and its specialized committees (audit committee, compensation committee, etc.): and it should be an occasion for opening up a genuine constructive dialog with the shareholders.

The recommendations that follow have been written with reference to corporations with a board of directors, which remains the most common form of organization. Corporations with a supervisory board and management board, as well as partnerships limited by shares (*société en commandite par actions*), will need to make adjustments as appropriate to implement them.

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I – ROLE AND OPERATION OF THE BOARD OF DIRECTORS

The Companies Act of 1966 provided a very succinct definition of the board of directors: "*Corporations are governed by a board of directors (...). The board of directors has the broadest powers to act in all circumstances in the name of the company (...)*".

The first Viénot Report pointed out that "*regardless of its membership or how it is organized, the board of directors is and must remain a collegial body representing all shareholders collectively. It is required to act at all times in the interests of the company*." The Report also specified the board of directors' mission as follows: "*[The Board] defines the company's strategy, appoints the corporate officers responsible for managing the company and implementing this strategy, oversees management and ensures the quality of information provided to shareholders and to financial markets through the financial statements or at the time of very important operations.*"

This definition can now be found in article L 225-35 of the French Commercial Code: "*The board of directors sets the direction for company operations and oversees the implementation of strategy (...) it may deal with all issues relevant to the satisfactory running of the company and deliberates and decides upon all matters related thereto.*"

This definition confirms both the preeminent role of the board and the collegial nature of its decisions, one of the consequences being that directors are collectively responsible for decisions that have been made.

Although procedural rules and recommendations concerning the operation of the board and its committees are essential corporate governance standards, any procedure will only be as good as the people implementing it. ENRON complied formally with all these rules and was even considered a model of corporate governance!

The Viénot reports rightly emphasized the importance of the role of specialized committees in the satisfactory operation of a board of directors. These committees cannot be separated out from the board, their role is to facilitate its work and help with the effective preparation of decisions. The board's responsibilities thus should not be shifted onto the committees. For this reason in particular, the working group insists on the need for high-quality reports provided by the committees to the board and on the need to include in the annual report a description of the work of the committees.

The number and structure of committees will be matters for each board to decide upon. Thus, the audit committee's responsibilities generally span the review of the financial statements, risk monitoring and the supervision of internal audit, but in some companies there may be a specialized financial statements committee as well as an audit committee that specifically focuses on risk management issues. Similarly, the compensation committee and the nominating committee may be one and the same in some companies. Lastly, other types of committees may be created within the board of directors, such as a strategy committee.

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Following on from the Viénot reports, the working group once again emphasizes that for the following issues preparatory work must be undertaken by a specialized committee of the board of directors:

- Review of the financial statements
- Monitoring of the internal audit function
- Selection of statutory auditors
- Policy on remuneration and stock options
- Appointment of directors and corporate officers (*mandataires sociaux*)[(1)].

↳ The Board of Directors and Strategy

In some cases boards do not devote enough time to discussing strategic issues, and may sometimes even be informed only after the fact of investments, acquisitions or disposals that can have a major impact on the company's future. The same lack of prior discussion can also apply to issues of financing, indebtedness or liquidity. Such malfunctions contradict the principle of collegiality which should underlie the board's operation.

The working group considers that the board of directors' internal rules of operation should specify board procedures for dealing with such matters.

The board of directors' internal rules of operation should specify the following:

- Cases in which prior approval by the board is required, specifying the principles governing such approval, which may vary from one of the company's divisions to another.

- The principle that any material transaction that is not part of the company's announced strategy should require prior approval by the board of directors.

- The rules under which the board is informed of the company's financial position, cash flow situation and commitments.

All these rules should apply not only to external acquisitions or disposals, but also to any major organic growth investments or to internal restructuring operations.

↳ Directors' Access to Information

The second Viénot report emphasized that informing directors in advance and on an ongoing basis is an essential requirement for the satisfactory performance of their duties. This point remains as important today as ever.

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(1) In this report, the term of *mandataires sociaux* (translated as "corporate officers") applies to the chairman of the board, the chief executive officer and the chief operating officer(s) in companies with a board of directors, and to the chairman and members of the management board in the case of companies governed by a management board and supervisory board.

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The working group wishes to make four recommendations in this area :

1. Although competence should be one of the key criteria governing the selection of a director, it cannot be assumed that the newly-appointed person has in-depth prior knowledge of the company's organizational structure and operations. The director's knowledge of the company should therefore be rounded out as needed. Each director should be able to obtain, if he or she deems it necessary, additional training concerning the specific features of the company, its lines of business and its markets.

2. The company should on an ongoing basis be supplying its directors with all relevant information, including of a negative nature, concerning the company, notably press clippings and analyst reports.

3. The directors should meet the key executives of the company, including without the corporate officers being present. Of course, in such cases, the latter should be informed of the meetings beforehand.

4. A recent law enshrined the principle that "*each director should receive all information needed to fulfill his or her duties*" and that each director "*can obtain any and all documents that he or she sees fit to request*". The way in which this right of access to relevant documents can be exercised and the confidentiality obligations attached thereto should be further specified in the board of directors' internal rules of operation. Should the need arise, the board of directors as a whole would be responsible for deciding upon the relevance of any specific documents that have been requested.

II – BOARD OF DIRECTORS COMPOSITION

The quality of a board is determined first and foremost by its membership. Directors need to be not only individuals of good character, who have a sound understanding of the workings of the company and have a lively concern for the interests of all shareholders. They should also play a sufficiently active role in contributing to board discussions and shaping strategy to be effectively involved in the collegial decision-making process, the outcome of which they should then support appropriately.

A board should therefore be a subtle mix of competence, experience and independence serving the company and its shareholders. The aspects of competence and experience cannot be over-emphasized as the key qualities of directors. Directors should have a strong command of the strategic issues at play in the markets where the company is present, and this requires a sound knowledge of its businesses.

A designation as independent director does not imply a value judgment. Independent directors are not by their personal qualities supposed to be different from the other directors in a way that would make them more disposed to act in the interests of the shareholders. The designation as "independent" simply goes to the objective situation of the director, who is thus deemed not to have any potential conflicts of interest with the company.

The question of the definition and number of directors qualifying as independent directors is once again a subject of debate in many countries. Definitions of independence vary from country to country, and the notion of "independent" is often mistaken, particularly in the

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United States and the United Kingdom, for "non-executive" or "external." The definition given by the Viénot II report is far more demanding:

> *An independent director is to be understood not only as a "non-executive director", i.e., one not performing management duties in the corporation or its group, but also one devoid of particular bonds of interest (significant shareholder, employee, other) with them. For the sake of simplicity, an independent director can be defined as follows: "A director is independent of the corporation's management when he or she has no relationship of any kind whatsoever with the corporation or its group which might risk coloring his or her judgment".*

The working group considers that this definition, which remains essentially sound, should be made more precise on one point, namely that the absence of relationship should apply not only to the company or its group but should be extended to cover relations with the executive management of the company or group.

The definition of independent administrator would therefore be drafted as follows:

"A director is independent when he or she has no relationship of any kind whatsoever with the corporation, its group or the management of either that is such as to color his or her judgment".

Although the quality of a board can never be equated with its percentage of independent directors – since what counts above all is that directors be competent, present and actively involved – the working group is convinced of the importance of this criterion. The Viénot II report called for boards to have "at least one third" of their directors be independent, and today we recommend that this proportion should rapidly be increased to half of the members of the board in companies that have a dispersed ownership structure and do not have any controlling shareholders.

With this in mind, the status of independent director, which today is often applied to quite different kinds of situations, should be discussed by the nominating committee and reviewed on a yearly basis by the board prior to publication of the annual report.

Following upon a proposal of the nominating committee, the board of directors should review on a case by case basis the situation of each of its members with regard to these criteria, then make known to the shareholders, in the annual report and at any general meeting of shareholders at which any directors are to be elected, the results of its review, so that the designation of independent directors is not carried out only by the company's executive management but by the board itself. The board of directors may consider that, although a particular director meets all of the above criteria, he or she cannot be held to be independent owing to the specific circumstances of the person or the company, due to its ownership structure or for any other reason, and the converse also applies.

For purposes of clarity, the criteria that the committee and the board should examine in order to determine whether a director can be called independent and help avoid the risk of

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conflict of interest between the director and executive management, the company or its group, should be as follows:

- The director is not an employee or corporate officer (*mandataire social*) of the company, nor an employee or director of its parent or of one of its consolidated subsidiaries, and has not been one during the previous five years.
- The director is not a corporate officer of a company in which the company holds, either directly or indirectly, a directorship, or in which a directorship is held by an employee of the company designated as such or by a current or former (going back five years) corporate officer of the company.
- The director is none of the following (whether directly or indirectly) a customer, supplier, investment banker or commercial banker – in each case :
    - which is material for the company or its group, or
    - for which the company or its group represents a material proportion of the entity's activity.
- The director does not have any close family ties with a corporate officer (*mandataire social*) of the company.
- The director has not been an auditor of the company over the past five years (article L 225-225 of the French Commercial Code).
- The director has not been a director of the company for more than twelve years[1].

As for directors representing significant shareholders of the company or its parent company, the working group proposes that they be considered independent as long as they do not in whole or in part control the company ; beyond a threshold of 10% of the share capital or voting rights, the board acting upon a report from the nominating committee, should examine individually each case in order to determine whether the given director may be considered independent or not, taking into account the composition of the share capital of the company and whether there exists potential for any conflicts of interest.

[1] The loss of the status of independent director based on this criterion should come into effect only at the end of the term within which the director completes 12 years on the board.

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III – EVALUATION OF THE BOARD OF DIRECTORS

The Viénot reports emphasized the importance of assessing board performance. It must be said, however, that very few boards of directors have carried out a formal evaluation of their own operation.

Evaluations nevertheless remain essential. Their aim should be to achieve the following three goals:

- assess the way in which the board operates,
- check that the important issues are suitably prepared for and discussed,
- measure the actual contribution of each director to the board's work through his or her competence and involvement in discussions.

The working group believes that annual evaluations are necessary, to be conducted as follows:

- Once a year, the board should dedicate one of the points on its agenda to a debate concerning its operation.

- There should be a formal evaluation at least once every three years. It could be implemented, possibly under the leadership of an independent director, with help from an external consultant.

- The shareholders should be informed each year in the annual report of the evaluations carried out and, if applicable, of any steps taken as a result.

- In some countries, it is established practice that the directors that are external to the company (i.e. are neither corporate officers nor employees) meet periodically without the "in-house" directors. The majority of the working group recommends this practice. The internal rules of operation of the board of directors could provide for such a meeting once a year, at which time the evaluation of the chairman's and chief executive officer's respective performance would be carried out and the participants could reflect on the future of the company's executive management.

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IV – THE AUDIT COMMITTEE

The Viénot reports recommended the setting up of audit committees (also known as financial statements committees). The working group reaffirms the importance for listed companies of having an audit committee, whose mission cannot be separated from that of the board of directors which is responsible for approving the parent company and consolidated financial statements. Thus the audit committee must not take the board's place with regard to these responsibilities, but must remain an arm of the board that facilitates the board's work. To ensure that the respective roles remain clear, the working group believes that a certain amount of formality should be maintained in the workings of the committee :

- Rules of operation specifying responsibilities and operating procedures should be drawn up by the audit committee and approved by the board.
- Its reports to the board must ensure that the board remains fully informed of the work of the committee.
- The annual report should include a description of the work of the audit committee for the given reporting period.

The definition of the responsibilities of the audit committee set out in the Viénot reports remains appropriate today. However, it appears that current practice sometimes lags behind the standards which have been set in the past for these committees. The working group re-emphasizes the importance of having audit committees carry out fully their proper mission.

➴ Composition

The Viénot report stated that independent directors should account for at least one-third of the members of the audit committee.

The working group recommends that the proportion of independent directors in the audit committee be raised to two-thirds and that no corporate officer (*mandataire social*) be part of its membership.
Further, if the nominating committee recommends that the chairman of the audit committee be reinstated for another term, this should be subject to specific review by the full board.

The chairman of the committee should be in charge of appointing the person responsible for keeping the minutes of the committee's meetings and preparing its meetings.

➴ Training of the Members

The members of the committee, in addition to their existing financial management and/or accounting expertise, should upon appointment be informed of the company's specific accounting, financial and operating features.

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➷ Working Methods

Audit committees should interview the auditors, but also the chief financial officer as well as the heads of the accounting and treasury departments. If the committee so wishes, it should be able to hold such hearings without the company's executive management being present.

The committees should review the scope of consolidation and, if applicable, the reasons why some companies have not been included.

The committees should be able to call upon outside experts if and when necessary.

As regards internal audit and risk control, committees should examine material risks and off-balance-sheet commitments, interview the head of internal audit, express their view of the organization of this department and be informed of its work program. They should be on copy of internal audit reports or of periodic summaries of these reports.

➷ Relations with Statutory Auditors

In addition to regularly interviewing the statutory auditors, including without the executive management being present, the committee should drive the process of selecting the statutory auditors, express an opinion on the amount of fees requested for statutory audit work and submit the results of the selection process to the board of directors.

The committee should be informed of the amount of fees paid by the company and its group to the audit firm and its network, and ensure that the amount and the proportion that the fees represent in the billings of the audit firm and its network do not risk jeopardizing the independence of the auditors.

More generally, the committee should monitor compliance with the rules designed to ensure auditor independence and that are recommended in this report.

➷ Review of the Financial Statements

The audit committee needs to be able to carry out its mission in full, and therefore:

- It must have enough time to conduct its review of the financial statements (at least two days prior to review by the board),
- Alongside the financial statements submitted for review, the audit committee should be provided with a report from the statutory auditors setting out key points, not only of results, but also of the accounting options that were selected, and with a report from the chief financial officer describing the company's risk exposures and material off-balance sheet commitments.

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V – COMPENSATION COMMITTEE

The compensation committee plays a very important role in the workings of the board of directors. This committee should not include any corporate officers (*mandataires sociaux*) and should include a majority of independent directors.

The working group again draws attention to the above requirements from the Viénot reports and wishes to make the following additional recommendations:

- Rules of operation laying out its responsibilities and operating procedures should be drawn up by the compensation committee and approved by the board.

- Its reports to the board must ensure that the board remains fully informed of the work of the committee.

- The annual report should include a description of the work of the compensation committee for the given reporting period.

↳ Compensation of Executive Management

Compensation policy for executive management is a major component of sound corporate management. It is healthy that this policy provide for a long-term partnership between the company, the shareholders and the key players in its medium-term strategy. It should seek to avoid some of the excesses that have occurred in the form of disproportionate focus on the short term, causing a divorce between the personal interest of executive managers and the company's interest.

Control over this policy by the compensation committee and the board must be a cornerstone of corporate governance.

French law already includes precise rules concerning transparency of compensation and benefits in kind granted to corporate officers (*mandataires sociaux*). The working group reviewed practices in other countries and the majority of its members felt that it was not advisable to alter the French rules under which the board of directors sets the compensation of the chairman, the chief executive officer and chief operating officers, and the shareholders are informed through the annual report, which must also include a discussion of the principles and processes applied in the setting of these officers' compensation.

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> The compensation committee has a central role to play in setting the variable portion of corporate officers' remuneration. It must define the rules governing the setting of this variable portion, ensuring that these rules are consistent with the annual performance evaluation of these corporate officers and with the company's medium-term strategy; it must then verify the implementation of these rules on an annual basis.
>
> It should also assess all compensation and benefits in kind received by these officers from other group companies, including, if applicable, pension benefits and any other benefits.

➯ Others Matters for this Committee

Further, the committee should be kept informed of policy governing remuneratio of the main executive managers who are not corporate officers. Naturally, the committee may call upon the participation of the corporate officers in this area.

➯ Stock Options

The working group wishes to point out from the outset that, due to differences among the various tax and legal environments, the term "stock options" covers very different realities and that some of the practices that have caused concern in certain countries are not possible in France.

The commonly-used term of stock options in fact covers two types of options: options to subscribe for new shares, on the one hand, and options to purchase existing shares on the other. Because they give rise to the issue of new shares, stock *subscription* options have a potentially dilutive effect for shareholders. The dilution of capital stock can reach substantial proportions if a large number of subscription options are granted. This was the case in a number of U.S. companies and in start-up ventures in various countries. Conversely, stock *purchase* options have no dilutive effect, since they only entitle the holder to purchase existing shares, although they can generate a gain or loss for the company upon exercise of the option. There is therefore a difference in nature between these two types of options. Major French companies have increasingly tended to grant stock purchase options rather than subscription options, to avoid this dilutive effect.

In contrast with the practices that have arisen in certain countries such as the United States, it should be noted that under French law:

- Only the general meeting of shareholders has the power to authorize the granting of options, to set their maximum number and to determine the main conditions of the granting process;

- The exercise price of the options, which is set based on stock prices at the time of granting, cannot subsequently be revised or altered regardless of stock price trends;

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- The holding period of options – the time between the granting of the options and the sale of the shares subscribed for or purchased upon exercise of the options – is directly determined in practice[1] by tax rules: five years minimum from the date of grant for options granted prior to April 2000, four years minimum for options granted after that date. These long holding periods ensure that options granted by French companies do not give their executive management an incentive to focus on a short-term vision. They truly align the management's interests with those of shareholders, in accordance with the very philosophy of stock options;

- Directors who are neither corporate officers nor employees are barred by law from receiving stock options;

- Companies are strictly prohibited from making loans to their executive managers or directors, whether for the purpose of exercising options or for any other purpose. To do so, or to receive such loans, would represent a misappropriation of corporate assets which carries criminal liability;

- Complete and transparent information is provided in the annual report concerning the options granted to corporate officers and the exercise of such options.

To improve further on existing practices, the working group makes the following four recommendations:

It strongly recommends rejection of discounts in the granting of options, in particular for options granted to the company's corporate officers.

It recommends that the general policy governing the granting of options be discussed within the compensation committee and that this committee issue recommendations to the board of directors. This policy, which should be reasonable and suited to the needs of the company, should be presented in the annual report and during a general meeting of shareholders when a resolution on the granting of stock options is on the agenda.

Options should be granted at set intervals to avoid any opportunistic granting of options during an exceptional drop in stock prices. Policy should distinguish between corporate officers, other executive managers and other grantees.

The committee should also make known to the board its proposals concerning the choice between granting subscription or purchase options, specifying the reasons for its choice as well as the consequences that this choice has.

A debate has arisen on the issue of whether stock options should be recognized as an expense. Such a debate is understandable when for tax purposes the cost of options (either subscription or purchase options) is deductible, as it is in the United States for immediately exercisable options, when the gain is considered as a salary. However, a different

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[1] Unless the holder is prepared to pay compulsory payroll deductions and income tax at the marginal rate on the capital gain.

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economic and legal rationale applies to options which bear more uncertainty due to the length of the holding period, as in France. Purchase options may entail a cost for the company. If, and only if, this proves in the result to be the case, should this cost be recognized as an expense – *i.e.* upon exercise of the options. Subscription options, however, have a dilutive effect for shareholders but do not have any impact on expenses.

↳ Compensation of Directors

The working group notes that the mode of allocation of this compensation, the overall amount of which is set by the general meeting, is determined by the board of directors. The allocation process should take into account the attendance record of each director at board and committee meetings, and therefore compensation should include a variable portion.

Taking into account the changing workloads and responsibilities of directors, each board should consider the appropriateness of the current level of attendance fees, whereby the primary concern should be that the level of compensation allow the recruitment of independent directors of suitable quality.

The rules governing the allocation of attendance fees and the individual amounts paid to directors should be presented in the annual report.

VI – THE NOMINATING COMMITTEE

The board of directors should always include a nominating committee, which may or may not be distinct from the compensation committee, and the chairman of the board should be a member of this committee. This committee plays an essential role in shaping the future of the company, as it is in charge of preparing the future membership of leadership bodies.

The role of this committee has been well defined in the Viénot reports. Its mission is particularly important as regards succession planning for corporate officers and the selection of new directors.

> The nominating committee should organize a procedure designed to select future independent directors, and carry out its own research on potential candidates before they have been approached in any way.

As for the other committees, the annual report should include a description of the work of the nominating committee over the reporting period.

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SECOND PART

Strengthening the Independence of Statutory Auditors

The involvement of the Andersen accounting firm in the Enron affair has sparked a number of reviews and discussions in all countries concerning the independence of auditors, i.e. those in charge of carrying out statutory auditing of the financial statements in the interests of shareholders.

The working group does not wish to encroach upon regulatory authorities' handling of this issue, as the *Commission des Opérations de Bourse* has begun work on the subject, nor upon the ongoing review by the accounting profession itself[(1)].

The working group has been informed of the work of the MEDEF Ethics Committee and approves its findings.

(1) The Le Portz reports issued in 1992 and 1999 set French practices well ahead of U.S. practices. The same applies to the work on professional ethics undertaken by the *Compagnie Nationale des Commissaires aux Comptes*.

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The working group wishes to draw attention to the following recommendations:

- Dual auditorship, a specific feature of the French system, greatly reinforces auditor independence. The dual auditing must of course be carried out in practice, meaning that the key issues coming to light during the preparation of the financial statements are truly reviewed twice.

- The term of office, set by law at 6 years, and the fact that it can be renewed, further reinforce independence. However it is also highly desirable that the lead partners in charge of the audit for major firms be rotated regularly, and that the terms of office of the two statutory auditors be staggered.

- The audit committee should be informed of the detail of fees paid by the company and its group to the statutory auditors and to other companies from the same group or network as the auditors.

- When the auditors' term of office expires, the selection or re-appointment of an audit firm should, upon a corresponding board decision, be subject to a tender process overseen by the audit committee, whose aim should be to select the best offer rather than merely the lowest price. The committee should issue an opinion concerning the amount of fees requested in the bids and make its recommendation to the board of directors.

- The statutory auditing of a listed company should be carried out to the exclusion of all other work for that company. The audit firm that has been retained should give up, for itself and the group or network that it belongs to, any consulting work (e.g., legal, tax or information technology consulting) that it has provided directly or indirectly to the company it has been selected by, or to its group.

However, subject to prior approval from the audit committee, ancillary work or work that is directly complementary to the audit of the financial statements can be carried out. As an example, acquisition due diligence audits may be acceptable ancillary work, but no valuation work should be allowed.

The working group believes that this strict approach will help strengthen the independence and responsibility of the statutory auditors.

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THIRD PART

Financial Information
Accounting Standards and Practices

Recent events have once again demonstrated the importance of high-quality financial information and the importance of accounting standards and practices.

The following discussion certainly will need to be explored further. The working group would hope to see AFEP and MEDEF play a full part, alongside the accounting profession, in this task which also directly concerns French and European regulatory authorities.

I – FINANCIAL INFORMATION

In terms of the periodicity of financial disclosures, the working group has preferred not to take a position concerning the controversial issue of quarterly accounts. Some feel that quarterly financial statements increase market volatility and promote a short-term focus to the detriment of companies' medium-term strategy. Others feel on the other hand that quarterly financial statements allow investors to adjust their positions more rapidly and also allow management to take corrective measures more rapidly.

It is up to each board of directors to define (within applicable legal constraints) the company's particular communication policy and to present it as transparently as possible to the market. However, each company needs to ensure that it implements a very strict policy in communicating with analysts and with the market. Some practices of "selective disclosure", designed to help analysts with their results forecasts, should be discontinued. The standard method of communication is the press release which provides the same information to all at the same time.

The working group believes that one of the key issues revolves around off-balance-sheet commitments and the company's risk exposure. Off-balance-sheet items can include a large number of commitments given and received, and are often highly varied, ranging from financial commitments to payroll-related matters to sales relationships. The content of off-balance-sheet items also varies according to the accounting standards used. This situation has sometimes caused insufficient attention to be paid to the commitments and risks resulting from liabilities not recognized in the balance sheet for various reasons, or even to a view that off-balance-sheet items constitute a kind of "regulation-free zone" beyond the reach of valuation and disclosure rules.

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A company's first obligation in this area is and remains the true and fair application of two core accounting principles: prudence and the primacy of substance over form. Once that is established, the two main objectives should be a careful valuation of off-balance-sheet commitments and of the risks they generate, and appropriate disclosures on these subjects. Each listed company must have in place reliable procedures to identify and value its commitments and risks, and to ensure to its shareholders and investors that it provides them with the relevant information on these matters.

In this context, the working group recommends:

- Indicating in the annual report what in-house procedures have been implemented to identify and control off-balance-sheet commitments and to assess the company's material risks.

- Developing and clarifying disclosures to shareholders and investors concerning material off-balance-sheet commitments and risks:

    - Providing specific information on these subjects in the annual report, presented in a clear and easily understood fashion;

    - Bringing together information on off-balance-sheet commitments in a specific note to the financial statements;

    - Bringing together information on market risks (interest rate, exchange rate, equity, credit, commodities) in a specific note to the financial statements;

    - In the event of a material exposure to interest rate, foreign exchange or commodity price risks, disclosing indicators of sensitivity to these risks, and specifying the methods and assumptions used to calculate these indicators;

    - Publishing ratings of the company issued by ratings agencies and any changes that have taken place in the reporting period.

In addition, accounting standard-setting bodies may have to take steps to design procedures that allow more appropriate presentation of off-balance-sheet items in the financial statements.

II – ACCOUNTING STANDARDS AND PRACTICES

Unlike the previous sections, this part of the report does not put forward recommendations for companies, but records the working group's views in this critically important area and its concern that the current efforts towards harmonization, which companies generally support, be based on principles and procedures that take due account of companies' needs as well as those of investors, intermediaries and regulators.

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The quality of accounting standards and practices is central to the satisfactory operation of financial markets and the development of companies. It is therefore essential that we have a single global set of standards that meets four quality criteria:

- Promoting the *stability* of financial markets, economies and corporate financing;
- Facilitating the *understanding* of companies' financial statements, key trends and risks;
- Being *applicable and recognized* by all economic players;
- Producing information that is *trustworthy*, i.e. *reliable and verifiable*.

Standards meeting these criteria would enshrine the principle of the "true and fair view" ("*image fidèle*") which is written into French legislation. Its absence in U.S. accounting standards is probably among the root causes of many of the recent events.

The adoption of IAS/IFRS(1) and the efforts deployed to make them as complete as possible represent major steps forward, which the working group wishes to acknowledge. There was an urgent need to put a halt to the risk of growing discrepancies developing between the accounting standards in force in various countries. In this regard, the attitude that U.S. authorities will adopt following the various accounting scandals that have arisen will play a major role in allowing or preventing the emergence of truly harmonized global standards.

Although significant progress has been achieved to date, some current trends in international standard-setting are a source of considerable concern, in terms of the objectives being pursued, the manner in which standards are produced and the results that derive therefrom.

The objectives being pursued place excessive focus on the short term and complicate the task of financial communication. Despite a constant lack of support from a majority of players and a risk of increased volatility, especially in results and stock prices, the International Accounting Standards Board (IASB) is seeking to impose fair value accounting regardless of the holding periods or management processes involved. This approach fails to sufficiently take into account the specific features of the items being valued and the limited relevance of the concept of a "market" for certain of these items, since in some cases all that is available is a theoretical valuation model.

The manner in which the standards are drafted often reflects both a lack of understanding of the difficulties encountered by those applying them and verifying compliance, and of the need to develop common standards that are applicable at the European and global levels. The IAS standard setting process remains unsatisfactory because not enough attention is paid to the views expressed by concerned parties. The ways in which the IASB determines its agenda and proposals, and the validations that they are subject to, all call out for reform.

Without a global and concerted vision of the purposes and content of standards, what we risk obtaining is complex, detailed and ultimately opaque financial information, rather than synthetic ("*synthétique*") disclosures on performance and sensitivity to risks that can meet the needs of the various users of financial statements.

(1) International Accounting Standards / International Financial Reporting Standards.

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In response to these trends, the working group issues the following recommendations to standard-setters and regulators:

① – As a basic principle, avoid balance sheet volatility and build on what has already been achieved

The aim of financial information is to meet criteria of quality. This means not creating artificial volatility of balance sheet data, and providing relevant and reliable information. Following on from the major progress achieved in the area of standardization, reaching these goals is now a matter of strengthening what is already in place, rather than departing into approaches that are at variance with the real economy and fail to offer the necessary prudence in valuations.

- ***Taking into account holding periods and management processes, particularly for long-term assets and liabilities***

Financial information standards for determining results must be tailored to the planned holding periods and to management processes. They should meet the needs of long-term investors, but also provide data on short-term valuations of certain items for comparison purposes, when these are relevant.

- ***Emphasizing the definition of indicators rather than frequent individual valuations***

Instead of seeking to impose accounting based on fair value or market value, which will necessarily be illusory or even misleading in the absence of reliable, consistent and comparable reference data, it would be far more profitable to focus on defining indicators, particularly indicators of sensitivity to certain market risks.

- ***Clarifying and harmonizing the information used***

Lastly, due to the inflation in data requirements, it is essential that standard-setters refocus their work on the key items of greatest interest to the users of financial statements. Indeed, what matters is that the data they use today be clearly defined and presented in a synthetic ("*synthétique*") fashion, particularly as regards off-balance-sheet items, risks and income data (e.g. operating income).

② – Reassess the process by which International Accounting Standards are drafted and approved

Drawing up a single set of standards should require taking into account the European environment and adhering as much as possible to principles that are universally applicable and accepted.

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- Defining and explaining clear principles

During the drafting process and in the standards themselves, the core principles at play and the approach selected must be clearly identified and presented. Focusing on these core principles will avoid the development of overly detailed and complex rules, with all the difficulties and risks that applying them and verifying compliance would entail.

The standards that are adopted must in any event allow assessment of a company's potential, liabilities and operations, and the material risks and uncertainties related to elements and activities of the business.

- Giving Europe the place it deserves in international standard-setting

The process by which International Accounting Standards are elaborated needs to be reformed so as to give Europe its rightful place in international standard-setting and to define a common global set of standards.

Emphasis should be placed on convergence between U.S. GAAP and IAS/IFRS, particularly as regards such project areas as business combinations and disclosure of results. The aim should be to seek unconditional acceptance of the IAS/IFRS by the United States.

The process by which standards are approved at the European level should ensure that European companies are not hampered by competition-distorting requirements, which could call into question the adoption in Europe of IAS/IFRS standards not recognized in the United States.

- Developing the dialog among issuers, investors and auditors with a view to achieving relevant, reliable and verifiable financial information

In order to develop applicable standards yielding relevant, reliable and verifiable financial information, the IASB's working procedures need to be reformed to better take into account the views expressed by all economic players, particularly issuers, investors and auditors. This assumes that companies will devote the necessary financial and human resources to this process.

Improving the IASB's "due process" should involve agenda-setting debates, broad distribution of documents submitted to the board, implementation tests for the solutions being considered and sufficiently long comment periods (e.g. 6 months for complex projects).

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CONCLUSION

Since the first Viénot report, French companies have developed and to a large extent put into practice a particularly thorough set of rules of corporate governance. They also carry on business within a legal and regulatory framework that provides further protection against many forms of excess. But given the extent of the turmoil and confusion that has followed certain cases of fraud in the United States or strategic and financial failures in France, the recommendations contained in this report may prove useful.

The report's recommendations on corporate governance or financial disclosures depend for their implementation on each company's individual decisions. As far as listed companies are concerned, the working group recommends that its proposals be implemented as rapidly as possible and at the latest by the end of 2003. In accordance with the terms of the Viénot II report, the annual report should include a discussion of to what extent the recommendations in the present report have been implemented.

All of the issues discussed in this report in relation to French companies are international in scope. The working group is convinced that the globalization of markets will necessarily lead sooner or later to a standardization of rules at the global level.

The recent adoption of new U.S. legislation on corporate governance, the Sarbanes-Oxley Act, which has an impact on European companies listed in the U.S., illustrates just how much Europe needs to speak with a strong and single voice to avoid the risk that regulation be carried out unilaterally by the United States. In these areas, French companies intend to be proactive promoters of change, as this report exemplifies.

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Appendices

- Mission letter (in French)
- Membership of the working group

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AFEP-AGREF
Le Président

MEDEF
Le Président

Monsieur Daniel BOUTON
Président Directeur Général de la
SOCIETE GENERALE
Tour Société Générale
17, cours Valmy
92972 PARIS LA DEFENSE 7

Paris, le 22 avril 2002

Monsieur le Président,

Les répercussions de l'actualité internationale font apparaître la nécessité de se pencher à nouveau sur un certain nombre de principes relatifs au gouvernement d'entreprise, à l'information et la communication financières ainsi qu'à la pertinence des règles comptables. D'importants travaux de place, déjà réalisés au cours des dernières années, ont entraîné de substantielles évolutions dans la gouvernance des entreprises et la notoriété de la place financière de Paris. Il s'agit aujourd'hui de mesurer si, à la lumière d'événements récents au retentissement mondial, l'adéquation entre l'attente des investisseurs et des marchés, d'une part et l'ensemble du corpus de règles, normes et comportements, d'autre part, reste satisfaisante.

Dans cet esprit, nous vous remercions vivement d'avoir accepté de présider un groupe de travail chargé d'examiner notamment les questions suivantes :

- l'amélioration du fonctionnement des organes de direction des entreprises, en particulier du comité d'audit ;
- la pertinence des normes et pratiques comptables ;
- la qualité de l'information et de la communication financières ;
- l'efficience des contrôles internes et externes (auditeurs et régulateurs) ;
- les relations des entreprises avec les différentes catégories d'actionnaires ;
- le rôle et l'indépendance des acteurs du marché (banques, analystes financiers, agences de notation…).

La question majeure du rôle et de l'indépendance des auditeurs sera examinée par le comité d'éthique du MEDEF présidée par M. René Barbier de La Serre qui participera par ailleurs à vos réflexions. Les propositions de ce comité seront versées aux travaux que vous mènerez.

Ce groupe de travail procédera aux auditions qu'il jugera nécessaires. Ainsi que nous en sommes convenus, M. Bernard Field assurera la fonction de Rapporteur Général et bénéficiera du concours d'un comité technique.

Il serait souhaitable de disposer de vos conclusions d'ici la fin juillet, compte tenu des réflexions en cours aux niveaux national et international et notamment des travaux européens.

En vous renouvelant nos remerciements les plus vifs, nous vous prions d'agréer, Monsieur le Président, l'expression de nos sentiments les meilleurs.

Bertrand COLLOMB

Ernest-Antoine SEILLIERE

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Membership of the Working Group

Chairman : **Daniel BOUTON, Chairman and Chief Executive Officer of SOCIETE GENERALE**

Members :
Euan BAIRD, Chairman and Chief Executive Officer of SCHLUMBERGER
Thierry BRETON, Chairman and Chief Executive Officer of THOMSON MULTIMEDIA
René BARBIER de LA SERRE, Chairman of the Committee on Ethical Questions of MEDEF
Jean-Dominique COMOLLI, Co-Chairman of ALTADIS
Jean-Martin FOLZ, Chairman of the Management Board of PEUGEOT S.A.
Denis KESSLER, Chairman of the Fédération Française des Sociétés d'Assurance (FFSA) (French Federation of Insurance Companies)
Igor LANDAU, Chairman of the Management Board of AVENTIS
Gérard MESTRALLET, Chairman and Chief Executive Officer of SUEZ
Edouard MICHELIN, ***Co-Gérant des Etablissements MICHELIN***
Jean PEYRELEVADE, Chairman of CREDIT LYONNAIS
René RICOL, Deputy President of the International Federation of Accountants (IFAC)
Serge TCHURUK, Chairman and Chief Executive Officer of ALCATEL
Serge WEINBERG, Chairman of the Management Board of PINAULT PRINTEMPS REDOUTE

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Rapporteur General : **Bernard FIELD, Corporate Secretary of COMPAGNIE DE SAINT-GOBAIN**

Deputy Rapporteur General : **Patrick SUET, Deputy Corporate Secretary of SOCIETE GENERAL**

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Technical Committee

<u>MEDEF</u>
Jacques CREYSSEL
Director General
Agnès LEPINAY
Director of Economic, Fiscal and Financial Affairs
Joëlle SIMON
Director of Legal Affairs

<u>AFEP</u>
Patrick ROCHET
Director General
Odile de BROSSES
Deputy Director of Legal Department
Francis DESMARCHELIER
Director of Financial & Accounting Information

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German Corporate Governance Code

as amended on May 21, 2003
(convenience translation)

Government Commission
German Corporate Governance Code

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1. Foreword

This German Corporate Governance Code (the "Code") presents essential statutory regulations for the management and supervision (governance) of German listed companies and contains internationally and nationally recognized standards for good and responsible governance. The Code aims at making the German Corporate Governance system transparent and understandable. Its purpose is to promote the trust of international and national investors, customers, employees and the general public in the management and supervision of listed German stock corporations.

The Code clarifies the rights of shareholders, who provide the company with the required equity capital and who carry the entrepreneurial risk.

A dual board system is prescribed by law for German stock corporations:

> The Management Board is responsible for managing the enterprise. Its members are jointly accountable for the management of the enterprise. The Chairman of the Management Board coordinates the work of the Management Board.
>
> The Supervisory Board appoints, supervises and advises the members of the Management Board and is directly involved in decisions of fundamental importance to the enterprise. The chairman of the Supervisory Board coordinates the work of the Supervisory Board.
>
> The members of the Supervisory Board are elected by the shareholders at the General Meeting. In enterprises having more than 500 or 2000 employees in Germany, employees are also represented in the Supervisory Board, which then is composed of employee representatives to one third or to one half respectively. For enterprises with more than 2000 employees, the Chairman of the Supervisory Board, who, for all practical purposes, is a representative of the shareholders, has the casting vote in the case of split resolutions. The representatives elected by the shareholders and the representatives of the employees are equally obliged to act in the enterprise's best interests.

In practice the dual board system, also established in other continental European countries, and the internationally widespread system of management by a single management body (Board of Directors) converge because of the intensive interaction of the Management Board and the Supervisory Board, both being likewise successful.

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The accounting standards of German enterprises are oriented on the “true and fair view” principle and represent a fair picture of the actual conditions of the asset, financial and earnings situations of the enterprise.

The **recommendations** of the Code are marked in the text by use of the word "**shall**". Companies can deviate from them, but are then obliged to disclose this annually. This enables companies to reflect sector and enterprise-specific requirements. Thus, the Code contributes to more flexibility and more self-regulation in the German corporate constitution. Furthermore, the Code contains **suggestions** which can be deviated from without disclosure; for this the Code uses terms such as “should” or “can”. The remaining passages of the Code not marked by these terms contain provisions that enterprises are compelled to observe under applicable law.

For Code stipulations relating to not only the listed company itself but also its group companies, the term “enterprise” is used instead of "company".

Primarily, the Code addresses listed corporations. It is recommended that non-listed companies also respect the Code.

As a rule the Code will be reviewed annually against the background of national and international developments and be adjusted, if necessary.

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2. Shareholders and the General Meeting

2.1 Shareholders

2.1.1 Shareholders exercise their rights at the General Meeting and vote there.

2.1.2 In principle, each share carries one vote. There are no shares with multiple voting rights, preferential voting rights (golden shares) or maximum voting rights.

2.2 General Meeting

2.2.1 The Management Board submits to the General Meeting the Annual Financial Statements and the Consolidated Financial Statements. The General Meeting resolves on the appropriation of net income and the discharge of the acts of the Management Board and of the Supervisory Board. It elects the shareholders' representatives to the Supervisory Board and, as a rule, the auditors.

Furthermore, the General Meeting resolves on the Articles of Association, the purpose of the company, amendments to the Articles of Association and essential corporate measures such as, in particular, inter-company agreements and transformations, the issuing of new shares and, in particular, of convertible bonds and bonds with warrants, and the authorization to purchase own shares.

2.2.2 When new shares are issued, shareholders, in principle, have pre-emptive rights corresponding to their share of the equity capital.

2.2.3 Each shareholder is entitled to participate in the General Meeting, to take the floor on matters on the agenda and to submit materially relevant questions and proposals.

2.2.4 The chair of the meeting provides for the expedient running of the General Meeting.

2.3 Invitation to the General Meeting, Proxies

2.3.1 At least once a year the shareholders' General Meeting is to be convened by the Management Board giving details of the agenda. A quorum of shareholders is entitled to demand the convening of a General Meeting and the extension of the agenda. The Management Board shall not only provide the reports and documents, including the Annual Report, required by law for the General Meeting, and send them to shareholders upon request, but shall also publish them on the company's Internet site together with the agenda.

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2.3.2 The company shall inform all domestic and foreign shareholders, shareholders' associations and financial services providers, who, in the preceding 12 months, have requested such notification, of the convening of the General Meeting together with the convention documents, upon request, also using electronic channels.

2.3.3 The company shall facilitate the personal exercising of shareholders' voting rights. The company shall also assist the shareholders in the use of proxies. The Management Board shall arrange for the appointment of a representative to exercise shareholders' voting rights in accordance with instructions; this representative should also be reachable during the General Meeting.

2.3.4 The company should make it possible for shareholders to follow the General Meeting using modern communication media (e.g. Internet).

3. Cooperation between Management Board and Supervisory Board

3.1 The Management Board and Supervisory Board cooperate closely to the benefit of the enterprise.

3.2 The Management Board coordinates the enterprise's strategic approach with the Supervisory Board and discusses the current state of strategy implementation with the Supervisory Board in regular intervals.

3.3 For transactions of fundamental importance, the Articles of Association or the Supervisory Board specify provisions requiring the approval of the Supervisory Board. They include decisions or measures which fundamentally change the asset, financial or earnings situations of the enterprise.

3.4 Providing sufficient information to the Supervisory Board is the joint responsibility of the Management Board and Supervisory Board.

The Management Board informs the Supervisory Board regularly, without delay and comprehensively, of all issues important to the enterprise with regard to planning, business development, risk situation and risk management. The Management Board points out deviations of the actual business development from previously formulated plans and targets, indicating the reasons therefor.

The Supervisory Board shall specify the Management Board's information and reporting duties in more detail. The Management Board's reports to the Supervisory Board are, as a rule, to be submitted in writing (including electronic form). Documents required for decisions, in particular, the Annual Financial Statements, the Consolidated Financial Statements and the Auditors' Report are to be sent to the members of the Supervisory Board, to the extent possible, in due time before the meeting.

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3.5 Good corporate governance requires an open discussion between the Management Board and Supervisory Board as well as among the members within the Management Board and the Supervisory Board. The comprehensive observance of confidentiality is of paramount importance for this.

All board members ensure that the staff members they employ observe the confidentiality obligation accordingly.

3.6 In Supervisory Boards with codetermination, representatives of the shareholders and of the employees should prepare the Supervisory Board meetings separately, possibly with members of the Management Board.

If necessary, the Supervisory Board should meet without the Management Board.

3.7 In the event of a takeover offer, the Management Board and Supervisory Board of the target company must submit a statement of their reasoned position so that the shareholders can make an informed decision on the offer.

After the announcement of a takeover offer, the Management Board may not take any actions outside the ordinary course of business that could prevent the success of the offer unless the Management Board has been authorized by the General Meeting or the Supervisory Board has given its approval. In making their decisions, the Management and Supervisory Boards are bound to the best interests of the shareholders and of the enterprise.

In appropriate cases the Management Board should convene an extraordinary General Meeting at which shareholders discuss the takeover offer and may decide on corporate actions.

3.8 The Management Board and Supervisory Board comply with the rules of proper corporate management. If they violate the due care and diligence of a prudent and conscientious Managing Director or Supervisory Board member, they are liable to the company for damages.

If the company takes out a D&O (directors and officers' liability insurance) policy for the Management Board and Supervisory Board, a suitable deductible shall be agreed.

3.9 Extending loans from the enterprise to members of the Management and Supervisory Boards or their relatives requires the approval of the Supervisory Board.

3.10 The Management Board and Supervisory Board shall report each year on the enterprise's Corporate Governance in the Annual Report. This includes the explanation of possible deviations from the recommendations of this Code. Comments can also be provided on the Code’s suggestions.

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4. Management Board

4.1 Tasks and Responsibilities

4.1.1 The Management Board is responsible for independently managing the enterprise. In doing so, it is obliged to act in the enterprise's best interests and undertakes to increase the sustainable value of the enterprise.

4.1.2 The Management Board develops the enterprise's strategy, coordinates it with the Supervisory Board and ensures its implementation.

4.1.3 The Management Board ensures that all provisions of law are abided by and works to achieve their compliance by group companies.

4.1.4 The Management Board ensures appropriate risk management and risk controlling in the enterprise.

4.2 Composition and Compensation

4.2.1 The Management Board shall be comprised of several persons and have a Chairman or Spokesman. Terms of Reference shall regulate the allocation of areas of responsibility and the cooperation in the Management Board.

4.2.2 At the proposal of the committee dealing with Management Board contracts, the full Supervisory Board shall discuss and regularly review the structure of the Management Board compensation system.

Compensation of the members of the Management Board is determined by the Supervisory Board at an appropriate amount based on a performance assessment in considering any payments by group companies. Criteria for determining the appropriateness of compensation are, in particular, the tasks of the respective member of the Management Board, his personal performance, the performance of the Management Board as well as the economic situation, the performance and outlook of the enterprise taking into account its peer companies.

4.2.3 The overall compensation of the members of the Management Board shall comprise a fixed salary and variable components. Variable compensation should include one-time and annually-payable components linked to the business performance as well as long-term incentives containing risk elements. All compensation components must be appropriate, both individually and in total.

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In particular, company stocks with a multi-year blocking period, stock options or comparable instruments (e.g. phantom stocks) serve as variable compensation components with long-term incentive effect and risk elements. Stock options and comparable instruments shall be related to demanding, relevant comparison parameters. Changing such performance targets or the comparison parameters retroactively shall be excluded. For extraordinary, unforeseen developments a possibility of limitation (Cap) shall be agreed for by the Supervisory Board.

The salient points of the compensation system and the concrete form of a stock options scheme or comparable instruments for components with long-term incentive effect and risk elements shall be published on the company's website in plainly understandable form and be detailed in the annual report. This shall include information on the value of stock options.

The Chairman of the Supervisory Board shall outline the salient points of the compensation system and any changes thereto to the General Meeting.

4.2.4 Compensation of the members of the Management Board shall be reported in the Notes of the Consolidated Financial Statements subdivided according to fixed, performance-related and long-term incentive components. The figures shall be individualized.

4.3 Conflicts of Interest

4.3.1 During their employment for the enterprise, members of the Management Board are subject to a comprehensive non-competition obligation.

4.3.2 Members of the Management Board and employees may not, in connection with their work, demand nor accept from third parties payments or other advantages for themselves or for any other person nor grant third parties unlawful advantages.

4.3.3 Members of the Management Board are bound by the enterprise's best interests. No member of the Management Board may pursue personal interests in his decisions or use business opportunities intended for the enterprise for himself.

4.3.4 All members of the Management Board shall disclose conflicts of interest to the Supervisory Board without delay and inform the other members of the Management Board thereof. All transactions between the enterprise and the members of the Management Board as well as persons they are close to or companies they have a personal association with must comply with standards customary in the sector. Important transactions shall require the approval of the Supervisory Board.

4.3.5 Members of the Management Board shall take on sideline activities, especially Supervisory Board mandates outside the enterprise, only with the approval of the Supervisory Board.

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5. Supervisory Board

5.1 Tasks and Responsibilities

5.1.1 The task of the Supervisory Board is to advise regularly and supervise the Management Board in the management of the enterprise. It must be involved in decisions of fundamental importance to the enterprise.

5.1.2 The Supervisory Board appoints and dismisses the members of the Management Board. Together with the Management Board it shall ensure that there is a long-term succession planning. The Supervisory Board can delegate preparations for the appointment of members of the Management Board to a committee, which also determines the conditions of the employment contracts including compensation.

For first time appointments the maximum possible appointment period of five years should not be the rule. A re-appointment prior to one year before the end of the appointment period with a simultaneous termination of the current appointment shall only take place under special circumstances. An age limit for members of the Management Board shall be specified.

5.1.3 The Supervisory Board shall issue Terms of Reference.

5.2 Tasks and Authorities of the Chairman of the Supervisory Board

The Chairman of the Supervisory Board coordinates work within the Supervisory Board and chairs its meetings.

The Chairman of the Supervisory Board shall also chair the committees that handle contracts with members of the Management Board and prepare the Supervisory Board meetings. He should not be Chairman of the Audit Committee.

The Chairman of the Supervisory Board shall regularly maintain contact with the Management Board, in particular, with the Chairman or Spokesman of the Management Board and consult with him on strategy, business development and risk management of the enterprise. The Chairman of the Supervisory Board will be informed by the Chairman or Spokesman of the Management Board without delay of important events which are essential for the assessment of the situation and development as well as for the management of the enterprise. The Chairman of the Supervisory Board shall then inform the Supervisory Board and, if required, convene an extraordinary meeting of the Supervisory Board.

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5.3 Formation of Committees

5.3.1 Depending on the specifics of the enterprise and the number of its members, the Supervisory Board shall form committees with sufficient expertise. They serve to increase the efficiency of the Supervisory Board's work and the handling of complex issues. The respective committee chairmen report regularly to the Supervisory Board on the work of the committees.

5.3.2 The Supervisory Board shall set up an Audit Committee which, in particular, handles issues of accounting and risk management, the necessary independence required of the auditor, the issuing of the audit mandate to the auditor, the determination of auditing focal points and the fee agreement. The Chairman of the Audit Committee should not be a former member of the Management Board of the company.

5.3.3 The Supervisory Board can delegate other subjects to be handled by one or several committees. These subjects include the strategy of the enterprise, the compensation of the members of the Management Board, investments and financing.

5.3.4 The Supervisory Board can arrange for committees to prepare Supervisory Board meetings and to take decisions in place of the Supervisory Board.

5.4 Composition and Compensation

5.4.1 For nominations for the election of members of the Supervisory Board, care shall be taken that the Supervisory Board, at all times, is composed of members who, as a whole, have the required knowledge, abilities and expert experience to properly complete their tasks and are sufficiently independent. Furthermore, the international activities of the enterprise, potential conflicts of interest and an age limit to be specified for the members of the Supervisory Board shall be taken into account.

5.4.2 To ensure the Supervisory Board's independent advice and supervision of the Management Board, not more than two former members of the Management Board shall be members of the Supervisory Board and Supervisory Board members shall not exercise directorships or similar positions or advisory tasks for important competitors of the enterprise.

5.4.3 Every member of the Supervisory Board must take care that he/she has sufficient time to perform his/her mandate. Members of the Management Board of a listed company shall not accept more than a total of five Supervisory Board mandates in non-group listed companies.

5.4.4 The election or re-election of members of the Supervisory Board at different dates and for different periods of office enables changing requirements to be taken into account.

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5.4.5 Compensation of the members of the Supervisory Board is specified by resolution of the General Meeting or in the Articles of Association. It takes into account the responsibilities and scope of tasks of the members of the Supervisory Board as well as the economic situation and performance of the enterprise. Also to be considered here shall be the exercising of the Chair and Deputy Chair positions in the Supervisory Board as well as the chair and membership in committees.

Members of the Supervisory Board shall receive fixed as well as performance-related compensation. Performance-related compensation should also contain components based on the long-term performance of the enterprise.

The compensation of the members of the Supervisory Board shall be reported in the Notes of the Consolidated Financial Statements, subdivided according to components. Also payments made by the enterprise to the members of the Supervisory Board or advantages extended for services provided individually, in particular, advisory or agency services shall be listed separately in the Notes to the Consolidated Financial Statements.

5.4.6 If a member of the Supervisory Board took part in less than half of the meetings of the Supervisory Board in a financial year, this shall be noted in the Report of the Supervisory Board.

5.5 Conflicts of Interest

5.5.1 All members of the Supervisory Board are bound by the enterprise's best interests. No member of the Supervisory Board may pursue personal interests in his/her decisions or use business opportunities intended for the enterprise for himself/herself.

5.5.2 Each member of the Supervisory Board shall inform the Supervisory Board of any conflicts of interest which may result from a consultant or directorship function with clients, suppliers, lenders or other business partners.

5.5.3 In its report, the Supervisory Board shall inform the General Meeting of any conflicts of interest which have occurred together with their treatment. Material conflicts of interest and those which are not merely temporary in respect of the person of a Supervisory Board member shall result in the termination of his mandate.

5.5.4 Advisory and other service agreements and contracts for work between a member of the Supervisory Board and the company require the Supervisory Board's approval.

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5.6 Examination of Efficiency

The Supervisory Board shall examine the efficiency of its activities on a regular basis.

6. Transparency

6.1 The Management Board will disclose without delay any new facts which have arisen within the enterprise's field of activity and which are not known publicly, if such facts could, owing to their impact on the asset and financial situations or general business development, substantially influence the price of the company's registered securities.

6.2 As soon as the company becomes aware of the fact that an individual acquires, exceeds or falls short of 5, 10, 25, 50 or 75% of the voting rights in the company by means of a purchase, sale or any other manner, the Management Board will disclose this fact without delay.

6.3 The company's treatment of all shareholders in respect of information shall be equal. All new facts made known to financial analysts and similar addressees shall also be disclosed to the shareholders by the company without delay.

6.4 The company shall use suitable communication media, such as the Internet, to inform shareholders and investors in a prompt and uniform manner.

6.5 Any information which the company discloses abroad in line with corresponding capital market law provisions shall also be disclosed domestically without delay.

6.6 The purchase or sale of shares in the company or of related purchase or sale rights (e.g. options) and of rights directly dependent on the stock market price of the company by members of the management board and supervisory board of the company or its parent company and by related parties shall be reported without delay to the company. Purchases based on employment contracts, as a compensation component as well as immaterial purchase and sale transactions (EURO25,000 in 30 days) are excepted from the reporting requirement. The company shall publish the disclosure without delay.

Corresponding information shall be provided in the Notes to the Consolidated Financial Statements. The shareholdings, including options and derivatives, held by individual Management Board and Supervisory Board members shall be reported if these directly or indirectly exceed 1% of the shares issued by the company. If the entire holdings of all members of the Management Board and Supervisory Board exceed 1% of the shares issued by the company, these shall be reported separately according to Management Board and Supervisory Board.

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6.7 As part of regular information policy, the dates of essential regular publications (including the Annual Report, interim reports, General Meeting) shall be published sufficiently in advance in a "financial calendar."

6.8 Information on the enterprise which the company discloses shall also be accessible via the company's Internet site. The Internet site shall be clearly structured. Publications should also be in English.

7. Reporting and Audit of the Annual Financial Statements

7.1 Reporting

7.1.1 Shareholders and third parties are mainly informed by the Consolidated Financial Statements. They shall be informed during the financial year by means of interim reports. The Consolidated Financial Statements and interim reports shall be prepared under observance of internationally recognised accounting principles. For corporate law purposes (calculation of dividend, shareholder protection), Annual Financial Statements will be prepared according to national regulations (German Commercial Code), which also form the basis for taxation.

7.1.2 The Consolidated Financial Statements will be prepared by the Management Board and examined by the auditor and Supervisory Board. The Consolidated Financial Statements shall be publicly accessible within 90 days of the end of the financial year; interim reports shall be publicly accessible within 45 days of the end of the reporting period.

7.1.3 The Consolidated Financial Statements shall contain information on stock option programmes and similar securities-based incentive systems of the company.

7.1.4 The company shall publish a list of third party companies in which it has a shareholding that is not of minor importance for the enterprise. The trading portfolios of banks and financial services companies, on which voting rights are not exercised, are disregarded in this context. The following shall be provided: name and headquarters of the company, the amount of the shareholding, the amount of equity and the operating result of the past financial year.

7.1.5 Notes on the relationships with shareholders considered to be "related parties" pursuant to the applicable accounting regulations shall be provided in the Consolidated Financial Statements.

7.2 Audit of Annual Financial Statements

7.2.1 Prior to submitting a proposal for election, the Supervisory Board or, respectively, the Audit Committee shall obtain a statement from the proposed auditor stating whether, and where applicable, which professional, financial and other relationships exist between the auditor and its executive bodies and head auditors on the one hand, and the enterprise and the members of its

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executive bodies on the other hand, that could call its independence into question. This statement shall include the extent to which other services were performed for the enterprise in the past year, especially in the field of consultancy, or which are contracted for the following year.

The Supervisory Board shall agree with the auditor that the Chairman of the Supervisory Board will be informed immediately of any grounds for disqualification or impartiality occurring during the audit, unless such grounds are eliminated immediately.

7.2.2 The Supervisory Board commissions the auditor to carry out the audit and concludes an agreement on the latter's fee.

7.2.3 The Supervisory Board shall arrange for the auditor to report without delay on all facts and events of importance for the tasks of the Supervisory Board which arise during the performance of the audit.

The Supervisory Board shall arrange for the auditor to inform it and/or note in the Auditor's Report if, during the performance of the audit, the auditor comes across facts which show a misstatement by the Management Board and Supervisory Board on the Code.

7.2.4 The auditor takes part in the Supervisory Board's deliberations on the Annual Financial Statements and Consolidated Financial Statements and reports on the essential results of its audit.

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London
STOCK EXCHANGE

Corporate Governance

A PRACTICAL GUIDE

RSM Robson Rhodes

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The author of this guide, Anthony Carey, is the RSM Robson Rhodes partner responsible for board effectiveness issues. He is a member of the Corporate Governance Committee of the Institute of Chartered Accountants in England and Wales.

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Foreword

BP has long recognised the importance of good governance and the pivotal role that the board plays in realising it. First, it is vital to understand what is meant by the term "corporate governance". For us it means "the system by which the owners of the corporation ensure that it pursues, does not deviate from and only allocates resources to its defined purpose". In a corporation that is a business, this defined purpose will be generating long-term shareholder value. To this end, boards are accountable for successfully governing and directing the corporation.

The foundations of world-class companies are laid in the boardroom. Companies need corporate governance policies that place the interests of their shareholders at the heart of the enterprise. In today's world of regulation and best practice codes it would be easy to think that compliance was sufficient. Nothing should be further from the truth – though best practice is just that, one size does not fit all and true governance best practice must be tailored for the unique facets of each corporation.

This guide has been developed by the London Stock Exchange and RSM Robson Rhodes LLP. It provides practical guidance on corporate governance issues for board members and other interested parties alike. It acknowledges that addressing a corporation's business purpose is critical while taking full account of the new regulatory and governance environment of the Combined Code on Corporate Governance for UK listed companies.

The guide covers a broad spectrum of issues from selecting and developing a high quality board and succession-planning to ensuring a board works effectively as a team. It goes on to explore a range of issues that a board must address if it is to enable the company to achieve its full potential including its input to strategy, effective risk management, communicating with shareholders and the development of an integrated approach to corporate social responsibility. It also discusses the work of board committees.

The effective stewardship of businesses entrusted to our care must remain high on the agenda of boards of all sizes and in all sectors. A successful economy depends on being able to build world-class companies which are leaders in the increasingly competitive global marketplace. Good governance is about enabling entrepreneurship and innovation within a framework of accountability. It demands sound judgement, high standards of probity and transparency in the relentless pursuit of the goals of the business.

Peter D Sutherland, KCMG

Chairman, BP p.l.c.

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A guide for the boardroom

The primary purpose of this guide is to help boards of listed companies to lead and direct their businesses successfully. It strives to provide practical insights into best practice on boardroom effectiveness so as to help boards achieve their strategic objectives and build enduring value in their businesses.

The guide takes account of the principles and provisions of the new Combined Code on Corporate Governance, applicable for financial periods beginning on or after 1 November 2003 to all UK incorporated companies listed on the London Stock Exchange. It also includes reference to other authoritative guidance.

Under the current listing rules, listed companies have to report on how they have applied the principles in the Code although the form and content of this part of their disclosure statement are not prescribed. Companies also have either to confirm that they comply with the Code's provisions or provide an explanation of any departures from them. It is expected that companies will normally comply with the provisions but recognised that departure may be justified in particular circumstances. The preamble to the Code emphasises that an evaluation of a company's governance should pay due regard to its individual circumstances including its size and the complexity of its business along with the risks and challenges it faces.

It is intended that companies quoted on AIM should also find this guide a useful resource though the Combined Code does not formally apply to them.

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Corporate Governance

A PRACTICAL GUIDE

The effective board

Building a talented board

Tying remuneration closely to performance

Strategic thinking

Managing risk effectively

A robust audit committee

Taking corporate social responsibility on board

An active dialogue with shareholders

Online resource centre

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The effective board

- Does the board have clear objectives and monitor its performance against them?
- Is the board focusing on the correct areas for its decision-making?
- Is the chairman leading the board effectively?
- Does the board provide a challenging yet supportive environment for the executive directors? Is there a full discussion before major decisions are taken?
- Is the board meeting schedule suitable for the needs of the business? Does the board receive board papers of the right length and quality? Are they provided in a timely manner?
- How have key board decisions turned out? How could the decision-making process be strengthened for the future?
- Is there a thorough boardroom appraisal process with a follow-up action plan?

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The effective board

"Every company should be headed by an effective board, which is collectively responsible for the success of the company. The board's role is to provide entrepreneurial leadership of the company within a framework of prudent and effective controls which enables risk to be assessed and managed. The board should set the company's strategic aims, ensure that the necessary financial and human resources are in place for the company to meet its objectives and review management performance. The board should set the company's values and standards and ensure that its obligations to its shareholders and others are understood and met".

These opening principles of the new Combined Code on Corporate Governance ('the Code') highlight the board's responsibility for leading and directing the company. The quest for world-class performance in the business must start in the boardroom. A summary of the specific provisions in the Code dealing with the functioning of the board is set out in Figure 1.1.

Leadership by the chairman

The chairman has a pivotal role to play in helping the board achieve its full potential. He or she is responsible for the leadership of the board, setting its agenda and ensuring its effectiveness. The chairman must facilitate effective contributions by the non-executive directors and ensure that there is a constructive relationship between them and the executive directors. The unitary board structure in the UK – with its mix of executive and non-executive directors on the board – makes the nature of those relationships absolutely crucial to an effective board.

In his book *Letters to a New Chairman,* [1] Hugh Parker says that the 'intangible quality of personal leadership' provided by the chairman is the one factor above all others that influences the effectiveness of any board. He believes that key elements of that leadership include having a sense of what he or she wants the organisation to do and become in the next five to ten years; a clear and definable set of objectives; strong personal views on how the company should seek to achieve those objectives; and, last but not least, real personal authority.

Figure 1.1 The board in action

Key provisions of the Combined Code

- **The board should meet sufficiently regularly to discharge its duties effectively. There should be a formal schedule of matters specifically reserved for its decision.**
- **Directors should receive accurate, timely and clear information. Management should provide such information but directors should seek clarification/amplification.**
- **The chairman should ensure that the directors continually update their skills and have the knowledge and familiarity with the company required to fulfil their role on the board and its committees.**
- **The chairman should ensure that the views of shareholders are communicated to the board as a whole. The chairman should discuss governance and strategy with major shareholders.**
- **The chairman should hold meetings with the non-executive directors without the executives present.**
- **The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.**
- **Where directors' concerns about the running of the company or a proposed action cannot be resolved they should ensure that they are recorded in the board minutes.**

Source: Extracted from The Combined Code on Corporate Governance, 2003 (abridged)

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Meanwhile, Sir Adrian Cadbury has likened the chairman's role [2] to being the conductor of an orchestra. He reflects that 'taking the chair at board meetings is the aspect of the job of chairman which is furthest from the public eye, but the one where their personal contribution is decisive'. The chairman must strike the balance between controlling the discussion in order to keep it to the point while encouraging board members to contribute to the debate.

Non-executive directors

The Code calls on non-executive directors to:

- constructively challenge and help develop proposals on strategy;
- monitor the reporting of performance;
- scrutinise the performance of management in meeting agreed goals and objectives;
- satisfy themselves on the integrity of financial information and that financial controls and risk management systems are robust and defensible;
- determine the appropriate level of remuneration of executive directors; and
- have a prime role in appointing and, where necessary, removing, executive directors and in succession planning.

Some of their duties will be performed on the board, others in board committees made up wholly – or mainly – of non-executive directors. The new Code indicates that the chairman should hold some meetings solely with the non-executive directors. In turn, the non-executive directors should meet at least once a year without the chairman present in order to appraise his or her performance. Those meetings with a non-executive focus should be included in the board's regular schedule to reduce the risk of executive directors worrying that they are excluded from certain meetings. In addition to formal meetings, the whole board and the non-executive directors as a group should meet informally on a periodic basis in order to improve their ability to work together as a team.

The efficient working of the board

Figure 1.2 sets out a number of issues that may help boards make their meetings more productive. The framework of issues that the board should consider are as set out at the beginning of this chapter. As part of its responsibilities for strategy and resources, the board should approve acquisitions and other major capital expenditure decisions, the financing of the business, and budgets and forecasts.

Figure 1.2
Successful board meetings

Some areas to consider:

- **The board agenda should strike a balance between long-term strategic and shorter-term performance issues. All directors should have the opportunity to put items on the agenda.**
- **Agenda topics should be supported by concise, informative papers with key points highlighted. Alternative courses of action should be proposed where relevant and the risks associated with proposed decisions should be noted and discussed.**
- **Ensure that papers are distributed in good time.**
- **Hold regular meetings including strategy away days.**
- **High attendance at meetings should be expected and achieved.**
- **Directors should come to meetings well prepared.**
- **The chairman should focus discussion around the principal issues in each agenda paper.**
- **All board members should feel able to contribute at meetings and do so.**
- **Major decisions should only be taken after a full discussion at board meetings.**

(Issues based on current good practice)

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A recent survey of large listed companies [3] reveals that most boards meet between eight and ten times each year – inclusive of strategy days, which can be a very valuable addition to the more routine meetings. Directors will find themselves subject to increased pressure to attend board and committee meetings in the future since the new Code requires that individual director attendance is publicly disclosed. This requirement and other considerations should be borne in mind when meetings are being arranged though the meeting schedule will obviously have to fit around calendar requirements such as the publication dates for interim and final results. The chairman also needs to ensure that arrangements have been put in place to allow for discussion among directors between meetings, for example, by telephone, teleconferencing or e-mail.

Information available to the board

The board needs information from inside and outside the company to enable it to monitor and review effectively the company's performance against its strategic objectives. This information should embrace financial and non-financial measures of performance, taking proper account of the company's own performance and prospects and how they compare to its principal competitors and the market leaders. The board should have a dashboard comprising a limited number of key performance measures with demanding targets against which to assess progress. In doing so, it should be careful to avoid excessive focus on short-term performance at the expense of a more broad-based understanding of the company's longer-term positioning.

Non-financial measures of performance might include:

- market positioning of key brands;
- customer satisfaction/retention;
- employee satisfaction and turnover;
- proportion of business attributable to new customers/products;
- R&D and innovation measures;
- social and environmental performance;
- shareholder and other key stakeholder assessments of the business.

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Figure 1.3

Performance evaluation of the board

- **Has the board met its performance objectives?**
- **What has been the board's contribution to the testing and development of strategy?**
- **What has been the board's contribution to robust and effective risk management?**
- **Is the composition of the board and its committees appropriate? Does it have the right mix of knowledge and skills to maximise performance in the light of future strategy? Are the board's relationships inside and outside the boardroom working effectively?**
- **How has the board responded to any problems or crises that have emerged? Could or should these have been foreseen?**
- **Are the right matters being reserved for the board?**
- **How well does the board communicate with the management team, employees and others? How effectively does it use mechanisms such as the AGM and the annual report?**
- **Is the board up to date with the latest developments in the regulatory environment and the market?**
- **How effective are the board's committees? Does each committee have the right composition? How do they interact with the main board? Do they fulfil their role?**

Source: Related Guidance and Good Practice Suggestions, The Combined Code on Corporate Governance, 2003 (abridged)

Performance evaluation and development

Human resources' best practice will no longer stop at the boardroom door: the new Code indicates that the board should undertake a 'formal and rigorous' evaluation of its own performance and that of committees and individual directors. At present, about two-thirds of companies undertake some form of collective board assessment [4] but even some of those are likely to review and strengthen their existing processes in the light of the wording in the new Code.

Good Practice Suggestions appended to the Code outline a series of questions to assist boards in assessing their performance and in identifying possible areas for future development (see Figure 1.3). The guidance also contains some questions on board procedures and on the chairman's contribution to the effective functioning of the board.

Boards will obtain the most out of their evaluation if they have set themselves objectives against which their performance can be measured. They will find it helpful to look back at some key decisions the board has taken in the past year to consider what can be learnt from them for the future. Was the information presented to the board at the time the best available? Would further analysis have been helpful? Bearing in mind what is known now, how well did the board address the main issues? Focusing on the challenges ahead will be equally, if not more,

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valuable. The board should think about how it needs to approach those challenges if it is to maximise the chances of achieving its goals. A number of boards are using questionnaires to identify issues for discussion. They should concentrate on those issues where most of the board consider improvement is needed or where there is a divergence of view among board members.

The evaluation should also consider how well the board works as a team. Is constructive challenge welcomed or is it seen as dissent? Does it feel like a unitary board or is there evidence of different factions? Are there any dominant players that might – even accidentally – be restricting the contribution of others? Some boards may find it useful to involve an external facilitator in the evaluation process. The facilitator can manage the information-gathering process and talk to individual board members to discover key issues for discussion. The external input can help raise issues that may not emerge if it was a purely internal process. Other boards may, however, feel more comfortable in having a private discussion on their collective performance. Whichever path is followed, the board should develop an action plan with set timescales to ensure changes are implemented as part of a process of continual improvement in the boardroom.

Boards may find it helpful to look at the chart (Figure 1.4) showing seven types of board - an effective board and six less successful variants. Each board should consider which unsuccessful elements it possesses – it may be more than one – and how it can best steer back towards the most effective model.

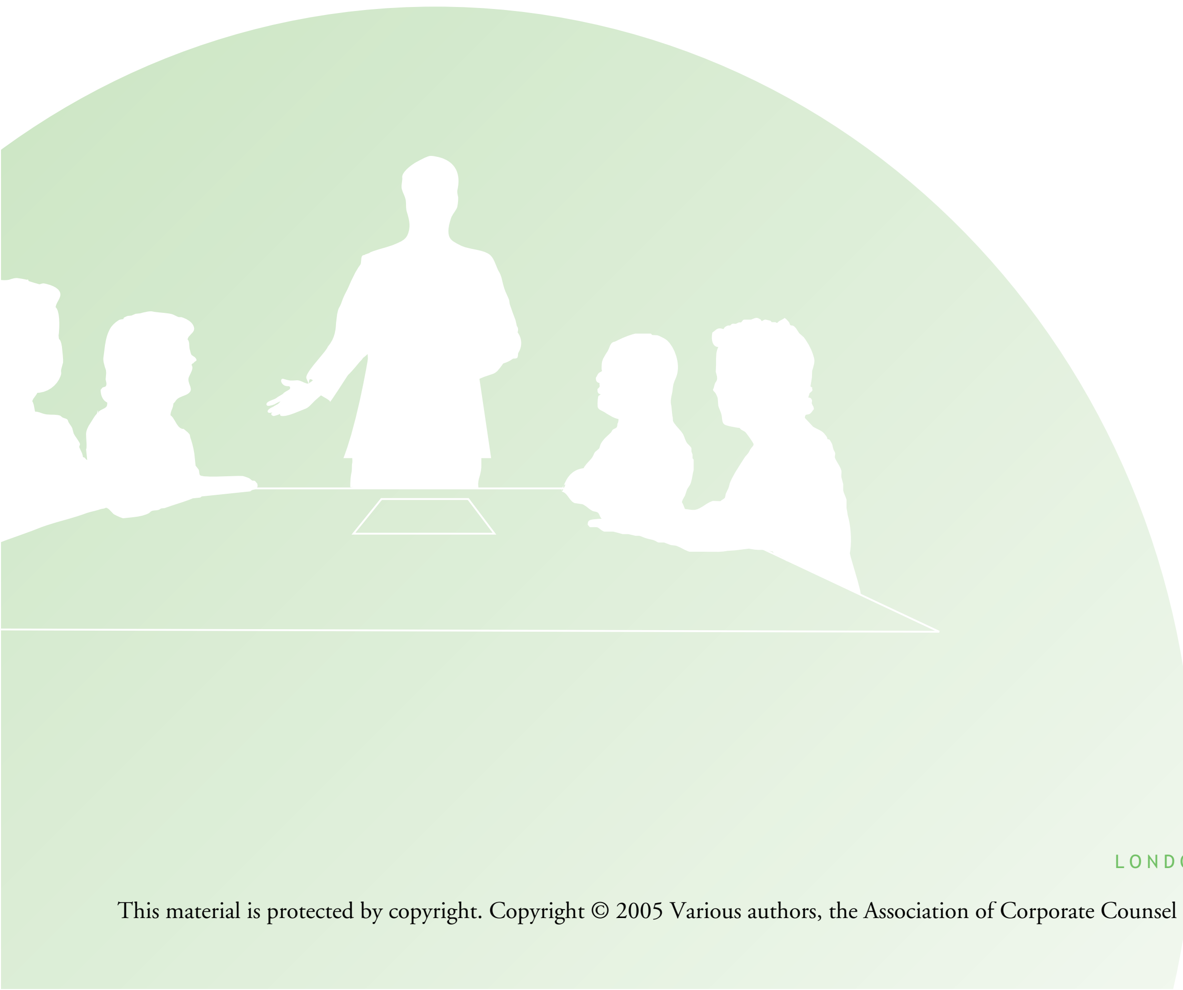

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Figure 1.4

Board Games: Common features of seven types of board - The effective board and those not achieving their full potential

Source: © 2004, RSM Robson Rhodes LLP

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Figure 1.5
Individual evaluation of non-executive directors

- **How well prepared and informed are the non-executive directors for board meetings? Is their meeting attendance satisfactory?**
- **Do they demonstrate a willingness to devote time and effort to understand the company and its business? Do they have a readiness to participate in events outside of the boardroom such as site visits?**
- **What has been the quality and value of their contributions at board meetings?**
- **How successfully have they contributed to strategy development and risk management?**
- **How effectively have they tested the information and assumptions with which they are provided? How resolute are they in maintaining their own views and resisting pressure from others?**
- **How effectively and proactively have they followed up on any areas of concern?**
- **Does their performance and behaviour engender mutual trust and respect within the board?**
- **How actively and successfully do they refresh their knowledge and skills? Are they up to date with market and regulatory developments?**
- **Are they able to present their views convincingly yet diplomatically? Do they listen and take on board the views of others?**

Source: Relevant Guidance and Good Practice Suggestions, The Combined Code on Corporate Governance, 2003 (abridged)

Most non-executive directors will not have previously been subject to individual assessment. The *Good Practice Suggestions* include proposed questions that might help form a template for discussion between the chairman and each non-executive on their performance (Figure 1.5). In certain circumstances the chairman may also provide constructive feedback offered by other directors. A balance needs to be struck though between a thorough evaluation and jeopardising the way in which the board works as a team.

It is the board's responsibility to review the effectiveness of its committees. Each committee should undertake its own performance evaluation but board members who are not on a particular committee should also have the chance to contribute to the process. The results and follow-up plans should be approved by the whole board.

Performance evaluations will provide useful insights into the training and development needs of the board and its individual directors. This has traditionally not been an area of high priority for many boards but the Code stipulates that new directors should receive a 'full, formal and tailored induction' on joining the board. All directors are expected to continually update their skills, knowledge of, and familiarity with, the company. As a result, many more boards are likely to want to establish board development and briefing programmes in the future.

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Disclosure

In the past, the disclosures about the board have largely centred on who is chairman, CEO and senior independent director; the names of board members serving on particular committees; and remuneration issues. The new Code goes much further and calls for the following additional disclosures:

- a statement of how the board operates, including a high level statement of which types of decisions are taken by the board;
- details of the number of meetings of the board/committees and individual attendance by directors;
- discussion of how performance evaluations have been conducted;
- disclosure of steps taken to ensure members of the board develop an understanding of the views of major shareholders about the company.

A light is being shone into the boardroom to highlight how it operates as well as how it is constituted. Boards will find, consciously or otherwise, that they are providing insights into how they are discharging their responsibility for stewardship of the company. The information provided will be closely analysed by institutional shareholders and other stakeholders.

References

(1) *Hugh Parker, Letters to a New Chairman, Institute of Directors, 1990*

(2) *Sir Adrian Cadbury, Corporate Governance and Chairmanship: A Personal View, Oxford University Press, 2002*

(3) *Spencer Stuart, 2003 UK Board Index*

(4) *Research study conducted by MORI for the Higgs Report – Review of the role and effectiveness of non-executive directors, 2003*

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Building a talented board

- What are the board's strengths and weaknesses?
- Is there a strong presence on the board of both executive and independent directors?
- Is there sufficient diversity among board members?
- What do institutional investors and other key stakeholders think of the board?
- What new skills and experience will be needed to enable the board to achieve its goals in the future?
- Is there effective succession planning for board and senior management appointments?
- Is there a formal, rigorous and transparent process in place for selecting new directors?

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Building a talented board

Building a talented board is a cornerstone of an effective corporate governance system. Following best practice on effective board meetings will be worth very little if you do not have the right people on the board in the first place. Recognising this, the new Code contains significant changes in relation to board appointments that may alter the shape of many boards over time. It includes a number of additional provisions relating to board structure and composition but the extent to which they will have their intended impact will be dependent upon the initial selection of board members. Their collective skills, experience and approach to running the business should make them the best suited to driving it forward and achieving the company's goals. The process for selecting new directors will require significant attention by the board and its nomination committee. Currently, only 32% of respondents to the *Board Effectiveness Survey*[1] agree that their boards have a rigorous independent process in place for selecting non-executive directors.

Board composition

For the first time the new Code draws a distinction between the number of independent directors that are expected to be on the boards of different sizes of listed company. For FTSE 350 companies, at least half the board (excluding the chairman) should comprise non-executive directors who are deemed independent. The boards of other listed companies should include at least two independent non-executive directors. This new two-tiered provision replaces the earlier one calling on at least a third of the board to be made up of non-executive directors, a majority of whom should be independent. The Code now includes a set of criteria that 'may appear relevant' in determining a director's independence (see Figure 2.1). The board may decide that a director is independent despite the existence of one of the specified relationships or circumstances but should then explain its reasons for doing so.

Figure 2.1

Reasons for challenging the independence of a director

- **Has been an employee of the group within the last five years**
- **Has had a material business relationship with the company within the last three years**
- **Received/receives additional remuneration apart from director's fee; is in company share option or performance-related pay scheme; or a member of the company's pension scheme**
- **Has close family ties with any of the directors, senior employees or advisers**
- **Holds cross-directorships/has significant links with other directors**
- **Represents a significant shareholder**
- **Has served on the board for more than nine years**

Source: The Combined Code on Corporate Governance, 2003 (abridged)

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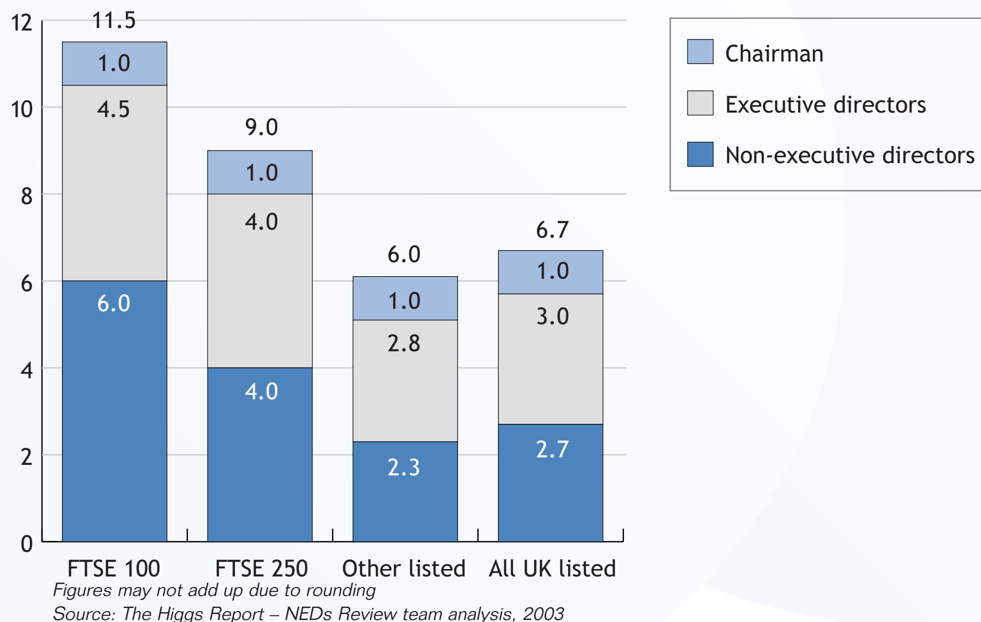
Figure 2.2

Average board size and composition



Figures may not add up due to rounding

Source: The Higgs Report – NEDs Review team analysis, 2003

The Code emphasises that the board should be of a sufficient size so that its members' skills and experience are appropriate for the needs of the business. The board's size should also allow it to change its composition without undue disruption. At the same time, it should not be so large as to be unwieldy and there should be a strong presence on the board of both executive and non-executive directors. Given that executive directors already comprise, on average, less than half the membership of most FTSE 350 boards (see Figures 2.2 and 2.3), these new provisions in the Code are unlikely to result in the hiring of large numbers of new independent directors. They are, however, likely to lead to high-profile challenges from institutional investors as to the independence of some long-serving, non-executive directors.

Figure 2.4 provides an overview of the current composition of the boards of UK plc.

Figure 2.3

Average size of boards

	FTSE 100	FTSE 250	Other listed
Executive Directors	3-6	2-5	2-4
Non-executive Directors	4-6	3-5	1-3
Total	9-12	7-10	5-7

NB: NEDs/Executive Directors figures exclude Chairmen

Source: The Higgs Report - NEDs Review team analysis, 2003

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Figure 2.4

Composition of boards of UK listed companies

Over 80% of those holding NED posts in UK listed companies hold one such post; comparative figure for chairmen is nearly 90%

Average age of FTSE 100 directors:

	Years
Chairmen	62
NEDs	59
CEOs	54
Executive Directors	51

Proportion of UK listed directorships held by women:

	FTSE 100	All listed
Chairmen	1%	1%
NEDs	11%	6%
Executive Directors	2.5%	4%

Source: The Higgs Report - NEDs Review team analysis of data, 2003

The chairman

The new Code clearly states that the roles of chairman and CEO should be split, with the division of responsibility between them clearly agreed and set out in writing. Research in 2003 showed that only 5% of FTSE 100 companies, 4% of FTSE 250 companies and 11% of other smaller listed companies still combined these positions. [2] All of those companies that fall into this group and that have institutional shareholders can expect continued pressure to have a separate chairman and CEO.

Upon his or her appointment the chairman should now satisfy the independence criteria set out in the Code. There is also a new provision that, save in exceptional circumstances, the chief executive should not go on to become chairman of the board, a relatively frequent occurrence until now. As a result, more boards are now likely to draw their future chairmen from among their independent board members. This is a factor that will need to be taken into account when selecting non-executive directors and when allocating them their subsequent board responsibilities.

Senior independent director

The Code advises that the board should appoint one of the independent non-executive directors to be the senior independent director. He or she should be available to shareholders to discuss concerns that they are unable to resolve through the normal channels of contact with the chairman, CEO or finance director. The senior independent director will also chair meetings of non-executive directors when the board chairman is not present.

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New board appointments

The board's nomination committee should evaluate the balance of skills, knowledge and experience of the board and, in light of this, prepare a description of the role, experience and skills required for a particular new appointment. This should be done as part of a routine succession planning process, designed to ensure that plans are in place for orderly succession to the board and other senior management positions. On the executive side, this is likely to involve key individuals being given opportunities to gain a breadth of experience within the business and to be visible to the board if they are not yet a member of it. The Conference Board has highlighted the main features of a successful succession planning process [3] (see Figure 2.5).

Looking at how an appointment will strengthen the board as a whole rather than considering each vacancy in isolation is welcome. There are plenty of examples in corporate history where highly talented individuals did not work well together as part of a team – to the detriment of all involved.

The nomination committee

The nomination committee has the responsibility for leading the process for board appointments and making recommendations to the board accordingly. A majority of its members should be independent non-executive directors. One of those independent non-executive directors or the chairman of the board should chair the nomination committee. An important point to note in the latter case: the board chairman should not lead the search for his or her own successor. For smaller listed companies with only two independent directors there would seem to be merit in having the company chairman on the committee as the third member in order to facilitate discussion among committee members.

The question of whether the company chairman should be permitted to chair the nomination committee was the subject of much discussion when the Code was being drafted. Given the chairman's responsibility for leading the board, a strong case can be made for his or her involvement in the committee alongside independent directors. That case is strengthened by the fact that the roles of the majority of chairmen are non-executive in nature.

Whereas the previous version of the Code discussed the need for a 'formal and transparent' procedure for the appointment of board members, the new Code has crucially added the word 'rigorous'. The earlier version of the Code also allowed companies with a small board – irrespective of the size of the company – to avoid the need for a nomination committee. That flexibility has now disappeared. As a result, many smaller listed companies will wish to establish a nomination committee in order to take on the detailed responsibilities allocated to it within the new Code. Last year, only 6% of FTSE 100 companies and 19% of FTSE 250 companies did not have a nomination committee but 71% of smaller company listed boards had yet to establish one. [2]

Figure 2.5
Elements of a good succession planning process

- **A continuous process**
- **Driven and controlled by the board**
- **Involves CEO input**
- **Easily executable in the event of a crisis**
- **Considers succession requirements based on corporate strategy**
- **Geared towards finding the right leader at the right time**
- **Develops talent pools at lower levels**
- **Avoids a 'horse race' mentality that may lead to loss of key deputies when the new CEO is chosen**

Source: The Combined Code on Corporate Governance, 2003 (abridged)

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Institutional investors and other stakeholders are increasingly focusing their attention on the quality of the board as a whole - including the independent directors - rather than just the management team and the chairman. The views of shareholders and other stakeholders will therefore be valuable to nomination committees as they seek to determine the board's strengths and areas for improvement. As such, nomination committees should ensure that they can easily access feedback from the financial community and other audiences. Comparing the board's composition relative to its main competitors and understanding the reasons for any substantial differences will also be worthwhile.

Issues for the nomination committee to address in evaluating the board's skills and experience will include:

- *Is the board reasonably diverse or does it run the risk of thinking in too uniform a fashion?*
  An overly homogeneous board can provide an insufficiently challenging environment for decision-making - a highly risky approach in today's fast changing business world. The board needs to be properly balanced to enable it to address the current and, in particular, future challenges of the business. There should be a mix of personality types so that there is lively discussion of issues with alternative courses of action considered. This requires the independent directors to strike the right balance between being challenging yet supportive of the executive team. Care should be taken to avoid different factions emerging. If this does happen some change in membership might be helpful. The board should have the right functional expertise, for example in finance, marketing, and people issues, but should also be able to give appropriate weight both to strategic and shorter-term tactical issues. There needs to be a good understanding of customers' needs along with the ability to engage the commitment of the workforce and to communicate effectively with shareholders. Groups that are still frequently under-represented include directors based in key markets outside the UK, women, younger directors, and those from ethnic minority backgrounds.
- *Does the board possess the in-depth experience necessary for the work of its committees?*
  The Code specifically calls for one member of the audit committee to have 'recent and relevant financial expertise'. However, questions about appropriate expertise should begin rather than end there. The remuneration and nomination committees are increasingly in the public eye and more boards may find it helpful to have a non-executive director with a human resources background to respond to these developments.
- *Is there a particular type of expertise that the board would find helpful in the future?*
  If a board knows that it will face a specific challenge in the near future but lacks the relevant expertise around the table it may be worth recruiting a non-executive with experience or skills in that field. That individual can then provide advice to the board as it moves forward. Examples may include a decision to improve corporate social responsibility performance, undergoing a major change management programme, growing new international markets, or planning an acquisition programme
- *Is the board being regularly refreshed?*
  The Code officially suggests that non-executive directors' independence comes into question after nine years. Despite this, many commentators would argue that two terms of three years each should be the normal benchmark for a non-executive director.

When new appointments need to be made, consideration should be given as to how they can best be phased in to ensure the smooth running of the board. Forward planning of this nature will be valuable if there is a perceived imbalance in the existing range of skills, experience or personalities represented on the board; problems related to the contribution of an individual board member; or simply a desire to keep a winning team refreshed. A description of the role and the desirable attributes for the new director should be prepared – this will help determine the form the search for the candidates will take and, for example, which headhunters or media outlets to use. A list of generally desirable characteristics for board members is shown at Figure 2.6.

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The Code calls for the company's annual report to disclose if neither an external search consultant nor open advertising has been used in the appointment of a chairman or of non-executive directors. This requirement highlights the expectation that informal contacts should not be the only means of identifying possible candidates. Smaller listed company boards, in particular, may find that thinking creatively about how to source candidates for non-executive appointments will pay dividends. They may find it helpful, for instance, to access registers held by a number of professional bodies or to approach leaders of successful unquoted businesses. Other tactics include building links with larger listed companies in the area which may be interested in enabling their high flyers to gain boardroom experience, recruiting those on career breaks from market leaders, or sourcing directors who have recently stepped down from senior executive positions.

Time available

The new Code makes it clear that companies should take steps to ensure that a potential chairman or non-executive director has sufficient time to undertake their duties. Those duties extend well beyond just attending meetings. They may include participating in site visits and relevant company activities, keeping up-to-date with developments in the company and the sector, and allowing time for adequate preparation for meetings. When appointing a chairman, an assessment of the expected time commitment should be set out in the job specification, including recognition of their need for availability in crises. The board should be made aware of a candidate's other commitments before any appointment is made and those details should then be disclosed in the next annual report once selection is confirmed.

Widening the pool

The new Code addresses the frequently raised concern that non-executive directors have often been drawn from a narrow pool based on existing directors' contacts. The aim of the measures set out in it is to ensure that board appointments are made on merit and against set objectives. Just as importantly, the requirements help stakeholders to verify that this has been the case via improved disclosure. Getting the appointment process right is important as it determines how effectively the board will function in the future. It will be most successful if the board and nomination committee are prepared to devote the necessary time and commitment to the selection of new board members.

Figure 2.6
Behavioural characteristics of a good director

- **Asks the difficult questions**
- **Works well with others**
- **Has industry awareness**
- **Provides valuable input**
- **Is available when needed**
- **Is alert and inquisitive**
- **Has business knowledge**
- **Contributes to committee work**
- **Attends meetings**
- **Speaks out appropriately at board meetings**
- **Prepares for meetings**
- **Makes long-range planning contribution**
- **Provides overall contribution**

Source: Corporate Governance Best Practices, Conference Board, 2003

References

(1) *RSM Robson Rhodes LLP and the London Stock Exchange, Board Effectiveness Survey, How does your board shape up? General results report, October 2003*

(2) *The Higgs Report, NEDs Review team analysis of data supplied by Hemscott, 2003*

(3) *Corporate Governance Best Practices, A Blueprint for the Post-Enron Era, Conference Board, 2003*

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Tying remuneration closely to performance

- Is the policy on directors' remuneration in line with guidance in the Code and with guidelines of relevant institutional investors' organisations? Are the institutional shareholders supportive of the company's remuneration policy?
- Has executive directors' pay and performance been fairly compared with that of a properly chosen peer group?
- Are targets set for bonuses and long-term incentive payments such that high rewards are only available for outstanding performance?
- Does the remuneration committee thoroughly assess whether the targets have been met before making awards?
- Are there any contract periods for executive directors in excess of one year? If so, can they be justified?
- Are arrangements in place to ensure that the company does not reward failure when directors leave early owing to poor performance?
- Is there a high level of transparency in publicly explaining how remuneration has been determined?

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Tying remuneration closely to performance

'Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for the purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance'.

While this principle in the Code enjoys broad support in the business community, controversy is likely to remain in relation to its implementation in particular cases. Among the issues attracting most attention are the extent to which there is a robust linkage between performance and remuneration; avoiding rewards for failure; and transparency of remuneration, both when arrangements are being put in place and once they have been agreed.

Composition and role of remuneration committee

The Code calls on listed companies to have a remuneration committee wholly made up of independent non-executive directors. FTSE 350 companies are expected to have a minimum of three members on their committee whereas smaller listed companies are allowed to have just two. The remuneration committee has responsibility for determining the remuneration for all executive directors and the chairman on behalf of the whole board. The committee also recommends and monitors the level and structure of remuneration for senior management, at least for the first layer below board level. The board itself should normally determine the non-executive directors' remuneration.

ABI Principles on Remuneration

The Association of British Insurers (ABI), whose members hold around 20% of the shares in UK listed companies, has issued *Principles and Guidelines on Executive Remuneration.* [1] These are consistent with the Code and provide a practical framework to help companies in determining their remuneration policy and shareholders in making their voting decisions. The principles call on remuneration committees to maintain 'a constructive and timely' dialogue with their major institutional shareholders and the ABI on remuneration issues. They also suggest that any departure from the stated remuneration policy should be the subject of prior shareholder approval.

The principles state that boards should demonstrate that performance-based remuneration arrangements are clearly aligned to business strategy and objectives, regularly reviewed and in line with current best practice. The ABI points out that simple remuneration structures assist with motivation and enhance the prospects of successful communication with the employees involved and with shareholders. Shareholders should also have their attention drawn to any special arrangements and significant changes since the previous remuneration report.

The *ABI Guidelines on the Structure of Remuneration* [1] call for companies to justify their actions if they are seeking to pay salaries over and above median levels. This is designed to avoid a continual upward ratchet effect on directors' remuneration which is inevitable if most companies aim to pay above the median benchmark. Setting base salary levels below the comparator group median provides more headroom for increasing performance-related pay. The guidelines also stress that shareholders do not support transaction bonuses as these provide rewards irrespective of the future financial outcomes of such deals.

Performance-related remuneration

The main provision in the Code on performance-related elements of remuneration indicates that they should align executive directors' interests with those of shareholders and give them 'keen incentives to perform at the highest levels'. More detailed provisions set out how this should be achieved. On annual bonuses, for example, the Code states performance conditions should be 'relevant, stretching and designed to enhance shareholder value'. Upper limits should be set and

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disclosed. The ABI *Guidelines for the Structure of Remuneration* [1] indicate that annual bonuses - which it notes will normally be payable in cash - can provide useful short-term incentivisation. It suggests that both individual and corporate performance targets are relevant in setting annual bonuses.

The key elements of the Code and the relevant ABI guidelines dealing with share incentive schemes are summarised at Figure 3.1.

Figure 3.1
Share-based incentive schemes - some key elements

Combined Code provisions

- **Shares granted or other forms of deferred remuneration should not vest, and options should not be exercisable, in less than three years. Directors should be encouraged to hold their shares for a further period after vesting or exercise, subject to the need to finance any costs of acquisition and associated tax liabilities.**
- **Any proposed new long-term incentive schemes should be approved by shareholders.**
- **Payouts or grants under all incentive schemes should be subject to challenging performance criteria reflecting the company's objectives. Consideration should be given to criteria that reflect the company's performance relative to a group of comparator companies in some key variables such as total shareholder return.**
- **Grants under incentive schemes should normally be phased rather than awarded in one block.**
- **The pension consequences and associated costs of base salary increases/other changes in pensionable remuneration should be considered especially carefully in the case of directors who are close to retirement. In general, only salary should be pensionable.**

Some additional elements in the ABI Guidelines for Share Incentive Schemes

- **Overall dilution under all schemes should not exceed 10% in any rolling ten year period. As a general rule, commitments under executive (discretionary) schemes should not exceed 5% of the issued share capital over a similar period.**
- **Vesting of awards should be conditional on meeting challenging performance conditions related to overall corporate performance.**
- **Total shareholder return relative to a relevant index/peer group is one of a number of generally acceptable performance criteria.**
- **Share-based performance awards should not be made for less than median performance. Initial vesting levels should not be significant in relation to annual salary. Where an annual amount exceeds one times salary, a clear explanation of the stretching nature of the performance criteria should be provided.**
- **Shareholders welcome the trend towards sliding scale awards related to the achievement of demanding and stretching financial performance against a target group or other relevant benchmark.**
- **Performance conditions should be measured over a period of three or more years. Strong encouragement is given to using periods of more than three years. There should be no automatic waiving of performance conditions in the event of a change of control or capital reconstruction.**
- **Schemes should be designed to encourage share retention so that directors build-up/maintain meaningful holdings in the context of their remuneration.**

Source: Extracted from Combined Code on Corporate Governance, 2003
and ABI Guidelines for Share Incentive Schemes, 2003 (abridged)

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Boards will also need to take account of the impact of the International Financial Reporting Standard on *Share-based Payment (IFRS 2).* [2] This will be applicable to listed companies' consolidated accounts for periods beginning on or after 1 January 2005 and is also being incorporated into UK GAAP. The standard requires a charge to be made to the profit and loss account in respect of the expense associated with share-based payments and may well have the effect of leading to more cash-based incentive schemes. It is also retrospectively applicable to grants of shares or share options from November 2002 that have not vested with the directors or other staff prior to 2005.

Not rewarding failure

Large pay-offs for departing executives in poorly performing companies have featured prominently in the business media for many years. Institutional shareholders also find them a real cause for concern.

The Code indicates that remuneration committees must carefully consider the total compensation commitments their company would have in the event of early termination of directors' contracts – including those relating to pension contributions. The aim is to avoid rewarding poor performance and the remuneration committee should take 'a robust line' on reducing compensation to reflect the departing director's obligation to mitigate loss.

The provision in the Code covering notice or contract periods has been strengthened. They should be one year or less and where it is necessary to offer longer periods to new directors recruited from outside the company they should reduce to no longer than one year after the initial period.

The ABI and the National Association of Pension Funds (NAPF) have produced a statement of best practice on executive contracts and severance that amplifies the guidance in the Code. Key elements of the guidance are shown in Figure 3.2.

Non-executive directors' remuneration

The Code states that the remuneration of non-executive directors should reflect their time commitment and responsibilities. The Smith Report on audit committees, appended to the Code, goes on to suggest that the remuneration of audit committee members may warrant particularly careful review in light of the now more demanding nature of the role. It says that 'consideration should be given to the time members are required to give to audit committee business, the skills they bring to bear and the onerous duties they take on, as well as the value of their work to the company'. In this respect, the remuneration of audit committee chairmen is likely to require particularly careful consideration. The extra emphasis placed in the new Code on the work of the nomination committee may also mean it is appropriate to review this committee chairman's remuneration – if he or she is not the board chairman. Meanwhile, if a company is setting up a nomination committee for the first time in the light of the Code's recommendations it will also be worth considering the additional time commitment that will be required from the relevant board members.

The Code indicates that non-executive directors should not be paid in share options since to do so might impact their independence. If, however, a company is absolutely intent on granting share options to its non-executives then it should seek shareholder approval prior to going ahead with the plan. Any options should not vest until at least a year after the non-executive director leaves the board. Where an executive director is a non-executive director at another company, the remuneration report should indicate whether they will retain the related earnings and, if so, the amount to which they are entitled.

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Figure 3.2

Severance terms - desirable features of arrangements

- **At the outset, boards should calculate the potential cost of termination in monetary terms. When agreeing the terms of the director's contract, boards should resist pressure to concede overly generous severance conditions. They should not support enhanced pension payments without being fully aware of the costs.**
- **Objectives set for directors should be clear. This will make it easier to determine whether an executive has failed to perform and therefore to avoid making payments for this element of remuneration in a severance package.**
- **Initial contract periods of more than one year may be appropriate in 'highly exceptional circumstances'. The example given is when a chief executive is recruited to a troubled company.**
- **Phased payments are welcome. These involve paying the departing executive, say, on a normal monthly basis for the outstanding term of his or her contract. The ABI/NAPF note that shareholders believe this approach has 'considerable advantages' if it is also made clear that the executive has a legal obligation to mitigate their loss as in many cases they will obtain further employment during the course of the payments, limiting future costs.**
- **The liquidated damages approach is not generally desirable. The amount that will be paid under this approach in the event of severance is agreed at the outset. Boards wishing to adopt this approach should consider modifying it to require arbitration to decide how much should be paid if severance occurs.**
- **Where a director is dismissed as a result of disciplinary action a shorter notice period than set out in the contract should apply.**
- **Consideration should be given to provide safeguards in extreme cases, for example if there were a very significant fall in the company's share price relative to the sector.**
- **Contracts should not normally provide compensation for severance as a result of change of control.**

Source: ABI/NAPF Best Practice on Executive Contracts and Severance, 2003 (abridged)

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Disclosure

The disclosure requirements dealing with directors' remuneration are now contained in the statutory based *Directors' Remuneration Report Regulations* [3] (see Figure 3.3 for a summary of the main disclosures).

The Remuneration Report Regulations introduced a new requirement for the directors' remuneration report to be approved by a resolution at the AGM. Entitlement to remuneration is not, strictly speaking, conditional on the resolution being passed. Despite this, it would be an unwise board that failed to heed a significant negative vote or abstention by shareholders even if a resolution was passed.

The ABI has welcomed the Remuneration Report Regulations as 'requiring both improved disclosures by companies in their remuneration reports and greater accountability to shareholders'. Its *Principles and Guidelines on Executive Remuneration* make it clear, however, that it expects companies to follow best practice as regards disclosure rather than simply to comply with the regulations. Its primary interest lies in having a full and clear explanation of policy with a clear link established between reward and remuneration. The ABI stresses that companies should undertake a consultation process as they formulate their remuneration policies rather than risk controversy when the resulting schemes are published in the annual report.

Figure 3.3

Key disclosures in the Directors' Remuneration Report

- **Names of remuneration committee members and those who provided advice to it.**
- **Statement of remuneration policy for the following and subsequent years.**
- **For each director, the policy statement shall include a summary of performance conditions regarding share options/long-term incentive schemes; an explanation of why they were chosen; and a summary of the methods to be used in assessing whether they have been met. The relative importance of elements that are/are not linked to performance are to be explained.**
- **A performance graph showing total shareholder return for the company for the last five financial years compared to that of a relevant broad equity market index.**
- **Details of directors' service contracts including potential early termination payments.**
- **Audited details for each director of their remuneration, interests/movements in share options, interests in long-term incentive schemes, pension details. Payments to past directors.**

Source: Department of Trade and Industry, Directors' Remuneration Report Regulations, 2002 (abridged)

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Promoting performance

Remuneration committees will find it helpful to carefully track total remuneration and its components over time. This should be done by reference to the return being earned by the company and its shareholders and to the company's performance relative to that of a comparator group. It is the remuneration committee's job when approving incentive schemes to ensure that the linkage between pay and performance is robust. They ought to check that the comparators chosen and the performance criteria set are genuinely challenging and that they are more suitable than possible alternatives. Members of the committee should also assess any 'small print' that may, for example, cover issues such as when the normal criteria may be waived.

The Code's exhortation to provide 'keen incentives to perform at the highest levels' involves building significant levels of leverage into remuneration packages. This does, however, need to be balanced against the risks of aggressive earnings management if those packages are too demanding. Outstanding performance should be very well rewarded but average or modestly above average performance should not unlock high levels of performance-related remuneration.

It is worth remembering that the way directors' remuneration is set is seen by institutional investors and others as an indicator of the board's overall stewardship – as well as being an important issue in its own right.

References

(1) Association of British Insurers, Principles and Guidelines on Executive Remuneration, 2003

(2) International Accounting Standards Board, IFRS 2 Share-based Payment, 2004

(3) Department of Trade & Industry, Directors' Remuneration Report Regulations, 2002

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Strategic thinking

- Does the group have a well-defined strategy?
  Have various alternative strategies been considered? Are the board and senior management wholeheartedly committed to the strategy?
- Is the strategy aligned with its distinctive capabilities to provide sustainable competitive advantage? Are the right people in the right roles to implement it?
- Does the group track its competitive environment on an ongoing basis? Is it in a position to respond to changes in that environment in a timely and effective manner?
- Are the key performance measures and risks to be managed directly derived from the strategy?
- Does the board keep the strategy - and its implementation - under regular review?
- Is the board communicating the strategy successfully to institutional shareholders and other key stakeholders? Are they fully supportive of it?

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A strategic approach to gaining a sustainable competitive edge

Writing over a decade ago, Hugh Parker [1] used a yachting analogy to divide the strategic approach of boards into two groups – 'day sailors' and 'ocean-racers'. The former follow whatever course the prevailing winds and tide allow, with the least effort and discomfort for the crew, and return to their moorings in the evening, back where they started. Successful ocean-racing teams, by contrast, have a definite objective and course to follow, recognise that they have a lot of tough competitors and possess a determination to win. They are highly organised and well-motivated with helmsmen, navigators, technicians and other specialists.

If boards are to fulfil their responsibilities under the Code to set the group's strategic aims they must be ocean-racers and make fundamental policy decisions – not just promote incremental improvements in operating efficiency. They must have a keen understanding of the current and likely future business environment; explore the range of strategic alternatives that are available; and be aware of the likely response of competitors to their chosen path. Above all else, they must be absolutely clear as to the drivers of their success and the threats to their prosperity in the years ahead. The board should also keep a sharp focus on the main objectives that must be fulfilled to keep the business strong and dynamic.

Developing a distinctive strategy

Constantinos Markides points out in *All the Right Moves, A Guide to Crafting Breakthrough Strategy* [2] that a strategic position is simply the sum of the company's answers to the three questions: Whom should I target as customers? What products or services should I offer them? How should I do this? He goes on to emphasise, however, that there are tough choices to be made within each of these three dimensions. It is just as much about the customers, products and services that the business will not target and the activities it will not pursue as those that it will. He argues that successful companies adopt a distinctive strategy based on a unique combination of the above dimensions so as to differentiate themselves from their competitors. Moreover, a failure to make clear choices in each of the dimensions is a common cause of strategic failure. Markides also stresses that strategy is dynamic. The advantages created by a unique position will eventually be eroded by competitive challenges. This implies that the only way to create enduring success is to perform well in the existing strategic position while continually searching for new positions. Once one has been chosen, the challenge lies in simultaneously managing the old and new approaches.

Markides suggests a company must define its business in order to be able to answer the who, what, how questions outlined above. The definition of the business must enable the company to fully leverage its unique competencies (or strengths). He says, for example, that a leading chain of coffee shops knows it is in the 'consumption experience' market and not merely selling coffee. In defining its business sector, a company needs to assess whether it is likely to grow, whether it is protected by barriers to entry and whether it delivers what the company needs in order to be able to succeed. For successful companies, the individual competencies and activities support and reinforce each other. Their power lies in their unique combination in a given business. The most valuable capabilities are those that cannot be imitated or substituted by others without significant expense.

Customer selection is not just about targeting potential new customers within the chosen section of the overall marketplace; it also involves looking at existing customers and asking which should be retained and which no longer fit with the chosen strategy. Likewise, having identified potential new products or services, businesses need to apply a cost-benefit screening mechanism, taking account of their competencies and their customer profiles, to see which will yield the best results. As with all aspects of a business, once products and services have been defined they should be kept under constant review. It is a process that drives continual innovation.

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Knowing at what you can be the best in the world

Markides' views on the necessity of a clearly-analysed, well-focused strategy are supported by Jim Collins in *Good to Great.* [3] He identified companies within the Fortune 500 list in the United States that had made the transformation from delivering good results to outstanding ones - and then sustained those results for a period of 15 years. Their average stock market return was about seven times that of the market over this period. Collins sought to identify common themes underlying their growth. He concluded that the 'hedgehog concept', drawn from Isaiah Berlin's observation that 'the fox knows many things, but the hedgehog knows one big thing', lay at the heart of their success. The *Good to Great* companies, in contrast to their less successful comparator companies, had a deep understanding of three key dimensions of their business and the interrelationship between them. They were clear what they could be the best in the world at and equally the areas in which they could not achieve such a level of excellence. They understood what drove their economic engine, that is how they could most effectively generate sustained profitability and cash flow. As part of this, they knew which measure of performance was the most important indicator of their success. Thirdly, they were very aware what they were deeply passionate about, in other words the areas to which they were really committed. Collins is clear that the issue is not just about having a good intention or plan to be the best at something but a genuine understanding of the fields in which you can excel.

Capturing the soul of the organisation

Earlier research by Collins with Professor Jerry Porras of Stanford University reported in *Built to Last* [4] again demonstrates the merits of a focused strategy playing to deep strengths within the business. The distinguishing characteristic of the companies in this study, all of whom had been successful over a prolonged period, sometimes generations, was that everything was subject to change except for 'a cherished core ideology' comprising the company's core purpose and core values. This core purpose 'captures the soul of the organisation' while the core values represent 'timeless guiding principles that require no external justification'. These might relate to customer service, quality, innovation, market responsiveness or teamwork, depending on the individual company. In summary, the core ideology is 'the bonding glue that holds an organisation together'. See Figure 4.1 for an example of the core ideology of a leading global pharmaceutical company.

Figure 4.1
Example of 'Built to Last' vision for a leading global pharmaceutical company

Core ideology

Core values

- **Corporate social responsibility**
- **Unequivocal excellence in all aspects of the company**
- **Science-based innovation**
- **Honesty and integrity**
- **Profit, but profit from work that benefits humanity**

Core purpose

To preserve and improve human life.

Envisioned future

To transform the company into one of the pre-eminent drug-making companies in the world, with a research capability that rivals any major university.

Source: Collins, J.C. and Porras J.I., Built to Last, Successful Habits of Visionary Companies, Random House 1994

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From drawing board to playing field

Boards need to be constantly alert to emerging strategic and market issues that call for strategic changes or 'jumps'. When the board decides that its present strategy will not lead the company in the desired direction in the longer term it will need to embark on a strategic review that may lead to a significant change in course. Implementing that change will require a significant level of leadership and commitment.

The *Good to Great* companies' leaders were committed to producing sustained high level results and took the difficult decisions to achieve this goal. Their actions were relentlessly consistent with their chosen 'hedgehog concept' (see Figure 4.2) and the combined impact generated great growth momentum. They were ambitious, but principally for the company rather than themselves, and laid the groundwork for their successors to achieve even more than they did. They first got the right people on the team before addressing issues such as strategy or organisational structure and did not hire people unless they were absolutely sure that they met the team's needs. They acted when they needed to make personnel changes but first checked they did not simply need to move someone into another position to make best use of their strengths. Perhaps most importantly, they put their best people to work on their best opportunities, not their biggest problems.

Overall, the transformation of 'Good to Great' companies was the result of cumulative effort with no single defining moment. Implementation of their strategy came down to persistent, consistent movement in the chosen direction over a sustained period. It was this dedication to the carefully chosen strategic goals that ultimately led to the point of breakthrough.

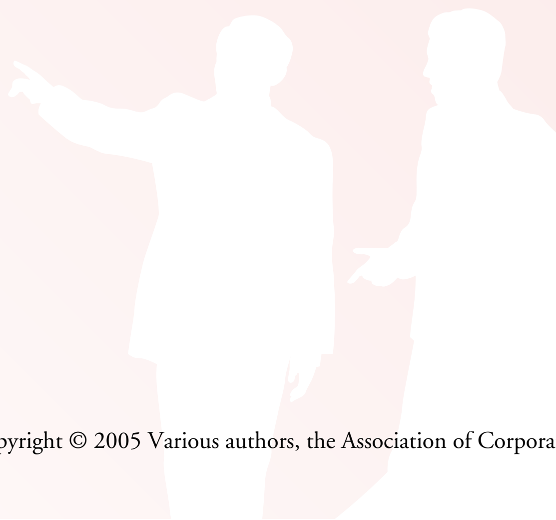

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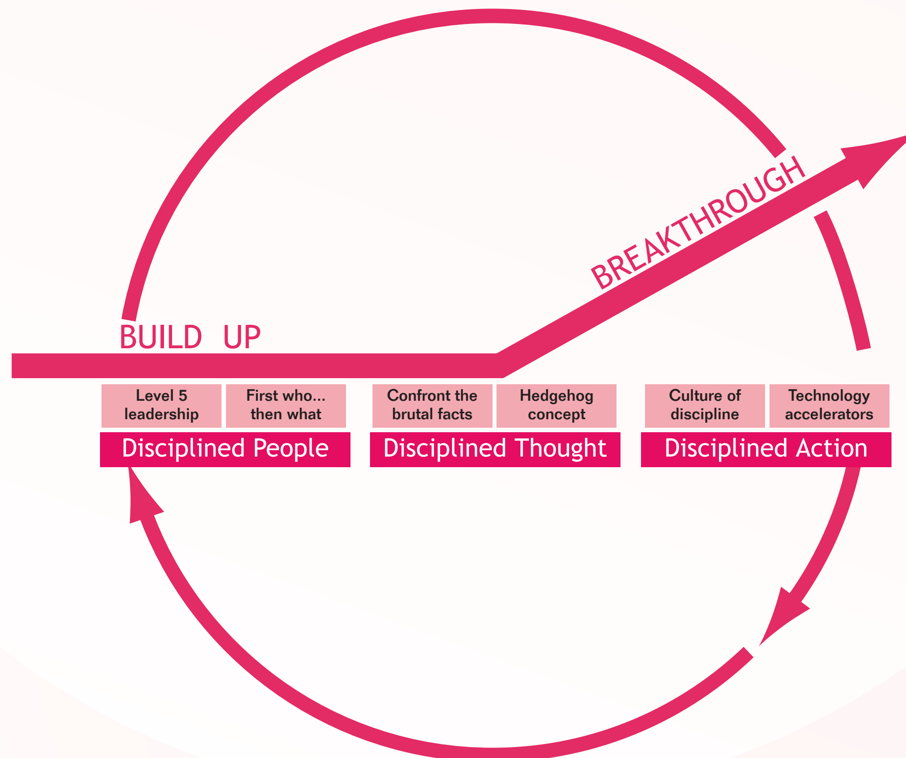
Figure 4.2

'Good to Great' - The key elements in the transformation



- Their leaders were a paradoxical mixture of personal humility and professional skills rather than the high profile/celebrity type (Level 5 leadership).
- 'They first got the right people on the bus, the wrong people off the bus, and the right people in the right seats – and then they figured out where to drive it' (First who --- then what).
- They maintained unwavering faith that they would ultimately prevail but at the same time had the discipline to confront 'the brutal facts of their current reality' (Confront the brutal facts).
- Their strategies were founded on a deep understanding of three key dimensions that guided all their decisions (Hedgehog concept).
- There was a culture of discipline – adherence to a consistent system but with freedom and responsibility within its framework (Culture of discipline).
- They did not use technology to ignite a transformation but were pioneers in the application of carefully selected technologies (Technology accelerators).

Source: Extracted from Collins, Good to Great, 2001(abridged)

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Implementing a successful change programme

In line with the above, Malcolm McKenzie stresses[5] that if the board decides a strategy and a change/transformation programme is needed, then it must deliver in five areas in order to be effective (see Figure 4.3). He suggests 'the strategy part is fun but not the most difficult part'. He considers it should take boards no more than three months to review, clarify and define the broad strategy and goals for the company. Where it takes significantly longer, he suggests that it is normally an indication that insufficient effort has been invested by the board in getting itself aligned around the key issues. The resulting transformation programme might, on the other hand, last one to two years.

Strong commitment must be secured throughout the organisation to the way ahead with effective management of the desired change. Without it, the effort will be wasted and potential performance improvements will not be realised. It is also essential to recognise that all change programmes will encounter ups and downs - the challenge is to navigate a route through what McKenzie calls the 'valley of despair'. Three key management actions will enable the business to pass through this phase successfully: recognition that the 'valley' exists; continuous communication, feedback and support to help key stakeholders through it; and understanding the importance of 'tipping points'. Tipping points occur when there is broad acceptance of the new strategy, process or way of working as part of everyday life. Achieving this takes real effort but a failure to reach the tipping point will lead to the old, embedded practices re-emerging triumphant. McKenzie suggests the answer lies in data-based arguments supporting the reason for change coupled with management of the political and emotional dimensions of it. Time needs to be spent consulting around solutions, coaching key influencers and addressing issues or resistance. Many transformation programmes fail because they start too many activities simultaneously and to avoid this problem the change should focus around no more than two or three work streams at any one time.

Quality time

Developing and implementing a strategy best suited to the business will largely determine whether or not the company has a successful future. The board should therefore ensure that it devotes enough time and resources to the task. It must be careful not to let its responsibility to monitor current performance deflect attention from the vital role of giving longer-term strategic leadership to the business. Where strategic change is called for, the role of the board is critical throughout the whole process. It needs to get alignment around the need for change, the strategic choices and the preferred final strategy. With consensus in the boardroom on this, its role is to commit, communicate, lead and mobilise the business as a cohesive team. The recent *Board Effectiveness Survey* of listed companies found that less than half of respondents were confident that their board had developed a strategy that gave their company a competitive edge in line with its capabilities. Many companies still have a long way to travel on their strategic journey.

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Figure 4.3

Implementing effective strategy and change programmes

The blueprint for the strategy

What is a simple articulation of how the company is going to compete? What is the business model? How will the various parts of the organisation work together?

The business case

What would happen if there were no change? What is the value that will be created by the new strategy? When, and how, can that be tracked?

The transformation programme

What are the key interventions that are going to be made? When? With what intended effect? How do these workstreams knit together to move the organisation towards its new goal?

A mobilised organisation

The board and cadre of senior management need, by this stage, to be committed and mobilised around the new strategy and transformation programme. There should be a plan as to how this mobilisation will be communicated and rolled out around the organisation.

A 'transformation map'

There should be a joined-up 'transformation map' allowing everyone to view the scope of the activities planned. This is not a timetable as such – rather a summary of the key activities and how they work towards the strategic goal. This enables linkages between the various activities to be more easily identified and accommodated. The transformation map also facilitates deciding which activities have to come first and which can be delayed.

Source: McKenzie, Institution of Mechanical Engineers, 2004

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Managing risk effectively

- Has the board determined its policies on risk management for the group? Is it clear on its risk appetite?
- Is the board satisfied that the corporate culture is supportive of the group's approach to risk management?
- Has the board identified the key risks inherent in the business? Is the nature of those risks regularly reviewed in the light of changes in the internal and external business environment?
- Does the board regularly receive reports on group risk management and ensure necessary improvements are made to maintain its effectiveness?
- Is the group able to respond effectively to unexpected crises? Have any arisen that should have been anticipated?
- Is risk management embedded in the board's decision-making processes? For example, does the board give due consideration to risk when weighing up mergers and acquisitions? Is there a proper recognition of reputation risk?
- Is the external reporting on risk management concise and insightful?

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Managing risk effectively

Profits are the reward for successful risk-taking in a modern competitive economy. Companies that are overly cautious will miss opportunities and are unlikely to succeed in the longer run. Even more certain failure awaits those who take risks recklessly. The board's challenge, therefore, is to ensure risk is managed effectively in the business, not to eliminate it altogether. The board has to be proactive in its oversight role and to recognise that the risks confronting a business are constantly changing.

The board's role

The board's risk management and control responsibilities include:

- Promoting a culture that emphasises integrity
- Embedding sound risk management in all aspects of the group's activities
- Approving the group's 'risk appetite'
- Determining its principal risks and ensuring that they are communicated to the business
- Setting the overall policies for risk management and control
- Adopting the most appropriate scheme of delegation of board responsibilities to committees
- Receiving reports on a timely and regular basis on the management of key risks and taking appropriate follow-up action. A list of the board's responsibilities with regard to the effectiveness of internal control is set out at Figure 5.1
- Integrating risk management into the board's own decision-making

The Turnbull Report on risk management and internal control is appended to the Code and provides guidance on the application of the relevant sections of it. It allows the board to delegate tasks to the audit or other board committees but the results of those committees' work should then be reported to, and considered by, the board. The board retains responsibility for internal control disclosures in the annual report. The new Code states that the audit committee should not only consider internal financial controls but should also review the broader internal control and risk management systems unless this has been specifically addressed by a separate risk committee made up of independent directors.

Figure 5.1

Board's role in reviewing the effectiveness of internal control

The board should define the scope and frequency of reports on internal control during the year. The annual assessment process should consider:

- **Key risks and their identification/evaluation/management.**
- **The effectiveness of the control system in managing those risks.**
- **Whether prompt action has been taken to remedy any significant failings/weaknesses.**
- **Any need for more extensive monitoring.**
- **Changes between annual assessments in significant risks and the company's ability to respond to changes in the business/external environment.**
- **Scope and quality of management's ongoing monitoring of risks and the work of internal audit/other assurance providers.**
- **Communication of monitoring results to board.**
- **Actual and potential impact of any failings/weaknesses on financial performance/condition.**

Source: Extracted from the Turnbull Report, appended to The Combined Code on Corporate Governance, 2003 (abridged)

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Focusing on the principal risks

The board should consider all types of risks – whether strategic, operational, compliance or financial. A list of possible risks is set out in Figure 5.2. The board's primary focus should be on the group's principal risks, many of which will be strategic but it should also ensure that financial and other basic controls are working effectively. Companies must identify and manage the risks that threaten the achievement of their objectives – this involves having clear, unambiguous and measurable objectives that emanate from the strategy.

To enable the board to decide which potential risks are most likely to be significant, management should advise it on the likely impact and probability of a range of events and circumstances. The board, with its 'helicopter view' of the business, can have a valuable input into this process but it does need to be complemented by the 'bottom-up' knowledge of those dealing with customers, suppliers and internal processes on a regular basis. Care needs to be taken on two fronts. First, the board must avoid taking too much of a 'top-down' approach to risk – an approach that floats over the organisational structure and is not embedded in it. Secondly, it should resist the danger of a 'bottom-up' approach that misses strategic risks by focusing only on day-to-day operational issues. Combining these approaches will, however, assist the board in identifying the 'gross' risks it faces – that is, risk before any mitigation measures are applied.

Determining the risk appetite

Armed with a list of 'gross' risks, the board can determine, with appropriate delegation to management, how these can be reduced to an acceptable level in line with the group's risk appetite. Risks may be controlled internally (for example, through supervision, division of responsibilities, quality control checks); transferred through insurance or avoided by declining particular types of business or by way of exclusion clauses in contracts. They can, of course, also be carried as acceptable risks.

The risks remaining after mitigation measures have been applied – the residual risks – are those that the board is willing to bear. The way in which risks are dealt with will depend on the group's 'risk appetite', namely, the amount of risk the board believes it is appropriate for the business to accept. The financial returns to the business, and their volatility around the mean, will vary according to the risk profile and the board needs to be confident that it has the capabilities and resources to cope with the one chosen. It also needs to be conscious of the preferences of shareholders - they will be influenced by whether they are holding the stock for growth or income purposes.

Boards need to be alert to circumstances where management may be tempted to undertake risky business transactions. Equally, they should ensure unnecessary controls are not imposed where the costs outweigh the benefits and which might stifle the spirit of entrepreneurship in the business. Appropriate opportunities to enter new markets, to develop products or services, or to be innovative in their creation or delivery need to be seized. Unnecessary delays or a failure to act can be very costly to the business.

Flexibility of response

The board should be satisfied that responsibility and accountability for managing risk is assigned to individuals at an appropriate level in the business. It should also ensure that there are 'early warning' mechanisms in place to identify problems when remedial action can still be taken. Successfully anticipating risks can prevent crises from occurring, saving valuable time and resources as a result. Companies also increasingly need the speed and flexibility to respond quickly and effectively to circumstances that could not have been foreseen. Contingency and emergency plans should be in place to minimise losses in the event that any crises do occur. These plans should be kept up to date, regularly tested and revised as a result of experience gained.

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Figure 5.2
Risks indicator

Strategic

- Unfocused strategy
- Strategy not aligned with capabilities
- Complacency arising from past success
- Unsuccessful acquisition/abortive bid
- Failure to manage major change initiative
- Reputational risk
- Loss of investors' confidence
- Political/general economic risk

People

- Leadership/management not able to drive company forward
- Inadequate succession planning
- Loss of key players
- Poor employee motivation
- Internal communication weaknesses

Marketplace

- Not responding to market trends/failure to innovate
- Missed opportunities – internet developments, global markets
- Weak brands
- Over-reliance on a few customers
- Poor level of customer satisfaction – quality/timeliness

Ethical

- Failure to enact high standards of ethics across business
- Obtaining contracts unethically
- Stakeholder concerns on products/business probity

Suppliers/outsourcers/ strategic alliances

- Over-dependence on suppliers/outsourcers
- Failure to manage cost/quality of outsourced service suppliers
- Supply chain problems – human rights, child labour
- Joint ventures, strategic alliances not working

Financial

- Cash flow/going concern problems
- Treasury operations risk
- Susceptibility to fraud/accounting irregularities

Legal/compliance

- Failure to protect intellectual property
- Health, safety, environmental issues
- Litigation risk
- Breach of competition, corporate, employee or taxation laws

Source: RSMi International, Building World-Class Boards, 2003 [4]

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Embedding risk management

The board should ensure that risk management is fully embedded in the organisation's culture and processes. Companies should have a code of ethics and be seen to uphold it when difficult choices have to be made. A code that is out of line with management behaviour, decisions and the way that incentives are granted in practice can be very corrosive so its application in practice must be kept under regular review. Arrangements should be put in place to encourage those with concerns about ethical breaches or other irregularities to come forward – if need be, independently of line management. Formal self-assessment processes can also have a significant role to play in successful risk management. They could, for instance, involve staff in key positions being asked to give a signed statement to the board concerning compliance with the company's ethical code and policies or confirming the reliability of accounting and reporting procedures. Risk management issues should also feature in the objective setting, appraisals and resulting remuneration of employees.

Communications and training across the group at all levels are essential to highlight everyone's risk management responsibilities. They can help develop a culture of continuous improvement with lessons being learned from any failures or weaknesses identified in the system. Companies should also learn from their competitors' problems or 'near misses', introducing new risk management systems or processes accordingly. That said, a balance needs to be struck between making sure experience informs future action and dealing with something that has already been and gone. The primary focus must be on addressing today's and tomorrow's threats to the achievement of objectives. Some pitfalls to avoid in risk management are listed in Figure 5.3.

Figure 5.3

Risk management pitfalls

- **Box-ticking rather than business-led approach.**
- **Failure to prioritise key risks.**
- **Too narrow a focus on financial risks.**
- **Not enough attention paid to changes in the internal or external environment.**
- **Board discussing risk but not integrating it into their own decision-making.**
- **Failure to embed risk management in organisational culture and processes.**

Source: RSMi International, Building World-Class Boards, 2003 [4]

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In the boardroom

The board has a responsibility to set a good example on risk management by carefully addressing risks in its own decision-making. Many of those decisions, by their very nature, will have a crucial impact on the company's future. Despite this, only just over a third of respondents (36%) to the *Board Effectiveness Survey* fully agreed that their boards ensure risk analyses are submitted to them prior to the approval of key initiatives.

Board-level discussion of risks will be essential, for example, in dealing with acquisitions. Companies with an experienced project manager working on acquisitions from identification until post-implementation evaluation are 71% more likely to have successful acquisitions than those who do not. [(1)] Issues to be addressed might include:

- Is there a strong business case for the acquisition? Has the target been carefully identified in line with the strategy rather than being forced to fit it?
- What risks might jeopardise achievement of the planned synergies?
- Are the political, regulatory and environmental risks understood?
- How will competitors react to the bid?
- Where it is desired for target management to be 'locked in', what mechanisms are in place to secure their motivation?

Capital structure risk also requires board attention. Once again, only 41% of *Board Effectiveness Survey* respondents were fully satisfied that their board has the necessary financial and human capital resources available to implement its chosen strategy. Prudent preventative measures in this area are likely to include: [(2)]

- the avoidance of excessive, short-term, confidence-sensitive debt;
- staggering debt maturities;
- maintaining cordial relations and credibility with banks during bad times and good;
- negotiating 'loose' bank loan covenants while the company is financially strong;
- maintaining bank lines in excess of anticipated needs;
- negotiating renewals well in advance of expiration;
- fully drawing credit lines at the onset of major difficulties.

Reputation risk must also be high on the board's agenda. Many leading businesses have enhanced internal controls, reviewed auditor/accounting relationships, revised codes of conduct and provided ethics-related employee training in response to the much publicised corporate scandals of recent years. The risks of unethical behaviour remain at the forefront of CEOs' minds when asked to identify the main threats to reputation. They rate alongside product/service problems, customer criticism, media criticism, a disaster disrupting operations and litigation or adverse court judgements. [(3)]

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Managing risks, taking opportunities

A wholehearted commitment to effective risk management will help create a forward-looking entrepreneurial business that is fully conscious of its external and internal environment – and of the constant changes in them. Such businesses will always be striving to set priorities, develop and improve.

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A robust audit committee

- Does the audit committee possess the necessary financial, business and governance expertise? Does it have enough meeting time to fulfil its remit effectively?
- Are all significant financial pronouncements thoroughly reviewed by the committee before they are publicly released? How is the company's quality of reporting regarded externally?
- Does the committee lead in the company's relationship with the external auditors? Does it actively monitor audit effectiveness and the auditors' independence?
- Are the company's internal financial controls and, where applicable, the overall internal control and risk management systems subject to rigorous ongoing review by the committee? Is any follow-up action monitored?
- Does the internal audit function make a substantial contribution to risk management in the business?
- Are the 'whistleblowing' arrangements to enable staff to raise concerns about possible improprieties working well?
- Are the annual report disclosures on the audit committee's work concise and insightful?

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A robust audit committee

'While all directors have a duty to act in the interests of the company the audit committee has a particular role, acting independently from the executive, to ensure the interests of shareholders are properly protected in relation to financial reporting and internal control.'

The Smith Report, appended to the Code, thus defines the role of the audit committee and provides guidance as to the application of the Code in these areas. Whilst this definition places a heavy burden of responsibility upon the members of the audit committee, the Smith Report goes on to point out that all directors still hold an equal legal responsibility for the company's affairs. As a committee of the board, any disagreements between it and the rest of the board should be resolved at board level. Where an issue cannot be resolved, the audit committee should have the right to include it in its report within the wider annual report.

The Smith guidance stresses that management is under an obligation to ensure that the audit committee is kept properly informed and should take the initiative in supplying information rather than waiting to be asked. The core functions of the committee relate to 'oversight', 'assessment' and 'review' of the functions carried out by management and the internal and external auditors. The high-level overview role may, however, result in the need for members of the committee to undertake detailed work. The Smith Report stresses that the audit committee must intervene if there are signs that something may be seriously amiss. Companies need to make the necessary resources available to audit committees to enable them to undertake their 'wide-ranging, time consuming and sometimes intensive work'.

The Code indicates that the main role and responsibilities of the audit committee should be set out in written terms of reference and should include the items shown in Figure 6.1. The overall role of the audit committee has not been changed significantly in the new Code. Despite this, the much more detailed discussion in the Smith Report as to how audit committees should discharge their responsibilities is likely to lead to many of them spending more time in fulfilling their remit. It may also require the companies to allocate more resources to assist them in their work.

Committee composition

All members of the audit committee should be independent non-executive directors. For FTSE 350 companies, there should be a minimum of three members and for other listed companies at least two members. The new Code adds that the board should satisfy itself that at least one member of the committee has recent and relevant financial experience. This requirement is likely to lead to a number of boards reviewing their audit committee membership. In practice, it will be generally helpful if the audit committee chairman has strong financial skills but it is also important that the committee members have good knowledge of the business and its sector. In addition, they should have appropriate personal characteristics such as the ability to ask challenging questions and to arrive at balanced judgements in complex situations.

The results of the committee's work should be considered by the board as a whole. Reports should include an indication of areas where action or improvement is needed and recommendations on how matters should be followed up.

Meetings of the committee

The Smith guidance recommends that there should be as many meetings as the audit committee's role and responsibilities require. It suggests at least three meetings a year, for example, when the internal and external audit plans are ready for review and when interim statements, the preliminary announcement and the full annual report are near completion. It should be stressed that three meetings is only a minimum recommendation – most audit committee chairmen will wish to call more meetings. The pressures on audit committees have undoubtedly

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Figure 6.1
The audit committee's main responsibilities

- **To monitor the integrity of the financial statements and any formal announcements on the company's financial performance.**
- **To review the company's internal financial controls and (unless done so by the board/separate risk committee) its internal control and risk management systems.**
- **To monitor/review the effectiveness of the internal audit function. If one does not exist, the committee should annually consider the need for establishing one, make a recommendation to the board and explain the reasons for its continued absence in the annual report.**
- **To make recommendations to the board on the appointment/removal of the external auditor and to approve their terms of engagement and remuneration. If the board does not accept the audit committee's recommendation, the committee should explain its recommendation in the annual report and the board should set out its reasons for taking a different position.**
- **To monitor/review the external auditor's independence/objectivity and the effectiveness of the audit process. If non-audit services are provided then the annual report should explain how objectivity and independence are safeguarded.**
- **To develop/implement policy on the engagement of the external auditor to supply non-audit services and to report to the board on actions/improvements needed in this area.**
- **To review arrangements by which staff may raise concerns about possible improprieties ('whistleblowing') in order to ensure arrangements are in place for their proportionate/independent investigation and for follow-up action.**

Source: The Combined Code on Corporate Governance, 2003 (abridged)

increased so looking forward it would be wise for boards to ensure their audit committee members have enough time at meetings to properly discuss their areas of responsibility. It would not be a good idea to unduly condense the time allocated to items in order to fit them in to the limited amount of time that has traditionally been available when a more appropriate solution would be to increase the number of meetings held.

Training and updates

In view of the pace of regulatory developments it is important to establish a development programme for audit committee members. The Smith guidance suggests training should be provided on an ongoing basis and should include an understanding of the principles of, and developments in, financial reporting and related company law. However, it will be helpful for the programme to go beyond regulatory and standard-setting issues to enable the committee to understand the environment in which the business is operating. Such training might cover emerging trends, developments in best practice, the results of relevant surveys and new supportive guidance that will assist the committee in fulfilling its remit. For the next few years at least, many companies may be applying International Financial Reporting Standards in their consolidated accounts and UK GAAP in other accounts. Audit committee members will need to be kept up-to-date on both sets of standards. Similarly, for those with US listings, it will be necessary to keep abreast of developments in accounting and regulatory issues on the other side of the Atlantic.

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Audit planning

The audit committee must ensure appropriate plans are in place for the audit at the start of each audit cycle. It should review the scope of the audit; the planned levels of materiality; the seniority, expertise and experience of the audit team; and the amount of time the auditors plan to spend on the audit. The committee should also agree the engagement letter with the auditor and be satisfied that an effective audit can be conducted for the proposed fee.

Review of audit findings

In reviewing findings from the audit, the Smith Report recommends that the audit committee should:

- discuss with the external auditor major issues that arose during the course of the audit. This should include issues that have subsequently been resolved and those that have been left unresolved;
- review key accounting and audit judgements;
- review levels of errors identified during the audit, obtaining explanations from management and, where necessary the external auditors, as to why certain errors might remain unadjusted;
- review the audit representation letters before signature by management, giving particular consideration where representation has been requested on non-standard issues; and
- review the management letter from the auditors and management's responses to their findings and recommendations.

Figure 6.2

Quality of financial reporting - areas of potential concern

- **Complex business/financing structures without obvious commercial rationale.**
- **Transactions/adjustments around the year-end having significant impact on the financial statements.**
- **Results that are difficult to explain from an understanding of the underlying business.**
- **Evidence of disagreements with auditors and/or management dominance of the audit team. Auditors experiencing difficulty/delays in obtaining sufficient audit evidence. Many misstatements found during audit.**
- **Doubts on quality of reporting expressed by analysts, rating agencies or financial media.**
- **Accounting policies/practices different from the industry norm, especially if there is a cumulative bias in the direction of management.**
- **Unusual trends in financial ratios – for example, cash flows not in line with expectations given turnover/profits, build-up of debtors/work in progress.**

(Issues to consider based on current good practice)

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Financial reporting

Management should inform the audit committee of the methods used to account for significant or unusual transactions where the accounting treatment is open to different approaches. When reviewing the company's annual financial statements, the audit committee should then:

- take account of the external auditor's view and consider whether the company has adopted appropriate accounting policies and made appropriate estimates and judgements;
- review the clarity and completeness of disclosures and consider whether they are properly set in context;
- review the Operating and Financial Review, the Directors' Remuneration Report, corporate governance and risk management statements and other information presented with the financial report; and
- report any concerns to the board.

As part of its review, the audit committee should stand back and make a judgement on the overall quality of the information being published. A list of some of the issues that might trigger concern is set out in Figure 6.2.

Evaluation of the auditor

The Institute of Chartered Accountants in England & Wales [1] has suggested a range of questions that the audit committee may wish to ask in evaluating the effectiveness of the audit process (see Figure 6.3). It suggests that the 'overarching' issue will be the quality of leadership in the engagement team as this will set the tone for the audit. One area that the audit committee might want to address is the quality of the audit partner's leadership in implementing the agreed audit strategy. The auditors should also be able to show that they are thinking about key issues and that they can interact effectively with the management team while challenging them, if required, on contentious issues.

Figure 6.3
Evaluating the audit process

- **Did the audit partners and senior audit staff have an up-to-date understanding of the business?**
- **How effectively did the audit work focus on major issues and did it deal appropriately with them?**
- **What recommendations were made for improvements to internal controls and other areas? Were they useful?**
- **Did the auditors make appropriate use of experts and technology in their audit work?**
- **What was the quality of comments and reports on the non-statutory items? For example, did the audit team report on the board's corporate governance statement?**
- **Was the work of internal audit used appropriately?**
- **Were formal audit documents, for example, the audit plan and management letters, of sufficient quality?**
- **Were the right numbers and quality of partners and staff used on the audit?**

Source: Extracted from The Institute of Chartered Accountants in England & Wales, Evaluating your auditors, 2003 (abridged)

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Independence and non-audit services

It is the audit committee's job to monitor the independence and objectivity of the auditor. It should seek information on an annual basis from the audit firm on policies and processes for maintaining independence and on how it monitors compliance with the relevant requirements.

The committee should develop a formal policy for the provision of non-audit services by the auditor. It should specify the types of work from which the external auditors are excluded, those for which they can be engaged without referral to the committee and those for which a case by case decision is necessary. The audit committee should also check that there are safeguards in place to ensure that there is no threat to audit objectivity and independence as a result of the provision of non-audit services. These checks will require a regular review of the nature of such services along with a comparison of the fees relative to the audit fee – for individual assignments and in aggregate.

Effectiveness of internal audit

An effective internal audit function can help provide assurance that there are appropriate corporate governance processes in place. It may be provided by employees of the company, outsourced or a mixture of both. A good internal audit function can also reassure investors and other stakeholders that:

- there is a robust risk management culture with all significant risks managed to the level agreed by the board;
- effective controls exist over all business operations to prevent undesired exposure to threats and to exploit opportunities; and that
- actions are underway to remedy any control deficiencies.

The Smith Report recommends that when reviewing internal audit the audit committee should:

- ensure that the head of internal audit has direct access to the board chairman and the audit committee, and is accountable to the committee;
- review and assess the annual internal audit work plan;
- receive a report on the results of the internal auditors' work on a periodic basis;
- review and monitor management's responsiveness to the internal auditor's findings and recommendations;
- meet with the head of internal audit at least once a year without management present; and
- monitor and assess the role and effectiveness of the internal audit function in the overall context of the company's risk management system.

To help audit committees appraise their internal audit function, the Institute of Internal Auditors – UK and Ireland has developed 30 questions as a starting point for the exercise. [2] Some of those questions are shown in Figure 6.4.

Whistleblowing

The Institute of Chartered Accountants in England & Wales has pointed out [3] that the audit committee should have a 'high level' role in relation to whistleblowing. As such, the committee is not responsible for any whistleblowing arrangements or their operation although follow-up action may be needed if there are signs that they are inadequate or ineffective. However, it suggests that the audit committee may wish to allow staff with concerns to contact its chairman directly. This open-door policy can be viewed 'as an effective method of demonstrating the board's commitment to the success of the process and its independence'.

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Figure 6.4

Assessing the effectiveness of internal audit - some key questions

- **Does the internal audit function have the appropriate technical expertise, qualifications and experience to provide assistance in all areas of the business?**
- **Has it given due consideration to the monetary/operational cost of control and assurance? Have these been balanced against the benefits?**
- **Have there been any significant control breakdowns or surprises in areas that have been reviewed by internal audit?**
- **Is the internal audit function benchmarked against industry best practice?**
- **Is it focused on key issues that concern the board?**
- **Can it respond quickly to changes within the organisation?**
- **Does the internal audit function ask powerful questions that stimulate debate and lead to improvements in key risk areas?**
- **Does management feel that recommendations made by internal audit are useful, realistic, forward-looking and meet their needs?**

Source: Extracted from The Institute of Internal Auditors – UK and Ireland, Appraising internal audit, 2003 (abridged)

The Institute's guidance on whistleblowing includes a range of questions that audit committees might ask. For example, are there issues or incidents the board has learned of which they would have expected to have been raised at an earlier stage? Has the internal audit function performed any work on the effectiveness of the whistleblowing procedures? Are there adequate procedures to track the actions taken in relation to concerns raised? Do those procedures ensure appropriate follow-up action has been taken?

An open working relationship

As the Smith Report highlights the most important features of the audit committee's relationship with executive management and the internal and external auditors cannot be drafted as guidance or put into a code of practice. It stresses that it is about 'a frank, open working relationship and a high level of mutual respect'. It goes on to note that 'the audit committee must be prepared to take a robust stand, and all parties must be prepared to make information freely available to the audit committee, to listen to their views and to talk through the issues openly'.

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(2) The Institute of Internal Auditors – UK and Ireland, Appraising internal audit, 2003

(3) The Institute of Chartered Accountants in England & Wales, Whistleblowing arrangements, 2003

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Taking corporate social responsibility on board

- Does the board's approach to corporate social responsibility flow directly from the corporate strategy?
- Is there a board member with a special remit for corporate social responsibility issues?
- Have key stakeholders been involved in determining the group's corporate social responsibility focus? What are their views on the group's approach and performance in this area?
- Are relevant external guidelines being followed?
- Have demanding targets and deadlines for action been set in key areas?
- Have the principal risks and opportunities related to corporate social responsibility been identified?
- Is there transparency in reporting progress made and in discussing the scope for further development?

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Taking corporate social responsibility on board

Listed companies are increasingly recognising that their social and environmental performance can help create long-term value for shareholders and other stakeholders. They have also begun to recognise that a failure to monitor and develop performance in these areas can destroy value in the business.

A recent World Economic Forum survey of business leaders [(1)] concluded that there is a growing consensus of the key business reasons for supporting corporate social responsibility best practice. These include:

- protecting and enhancing reputation, brand equity and trust;
- attracting, motivating and retaining talent;
- managing and mitigating risk;
- improving operational and cost efficiency;
- giving the business a licence to operate;
- developing new business opportunities – new products and services, new markets, new alliances, new business models; and
- creating a more secure and prosperous operating environment.

Figure 7.1 illustrates the main sources of pressure on business to adopt high standards of corporate behaviour. Successful businesses create a virtuous circle around their investors, employees, customers, suppliers and the communities in which they operate. Stakeholders will demonstrate a stronger level of commitment to companies that address their needs and expectations. Conversely, those who focus purely on short-term financial results, ignoring the problems that their businesses are causing to others, risk becoming caught in a vicious downward spiral. The result could be a declining reputation that leads to difficulties in attracting customers or good employees and eventually translates into a poor stock market rating.

Boardroom leadership

To be effective, a commitment to corporate social responsibility must have the wholehearted support of the board. It has to be a long-term commitment that involves ongoing improvement in measurement, verification, performance and reporting. Once decided, the company's position should be reflected in its statement of values or purpose and its core principles of doing business.

The board must also ensure that it devotes enough time to corporate social responsibility issues and that they are taken into account as a matter of course when, for example, making acquisitions or other major investments. It may be worth appointing an executive director with a special brief for corporate social responsibility issues across the business. Alternatively, when selecting independent directors there could be merit in appointing somebody with corporate social responsibility expertise and giving them a designated board leadership role in this area. A few boards have appointed a separate committee as a focal point for their work on corporate social responsibility.

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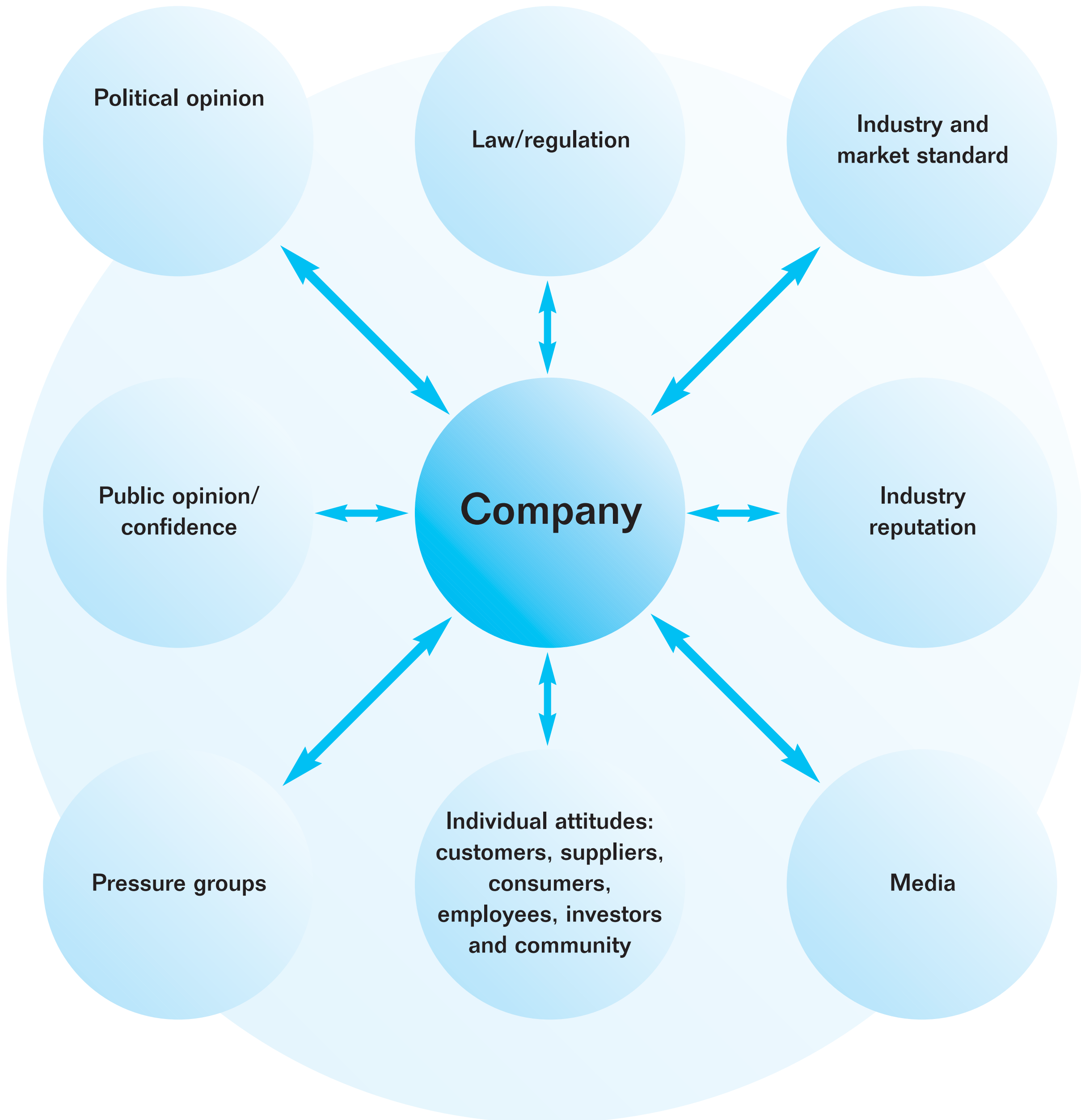
Figure 7.1

Sources of pressure on business



Source: Centre for Tomorrow's Company, included in Nelson, J. et al, The Power to Change, The Prince of Wales International Business Leaders Forum and Sustainability, 2001 [5]

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A company-specific focus

To have credibility, the group's corporate social responsibility policy and action plan must tackle the significant issues confronting the company. They should be treated as mainstream business issues.

A report commissioned by the Association of British Insurers (ABI)[2] has identified three recent general trends in corporate social responsibility that will help businesses formulate their approach. Firstly, corporate social responsibility is now widely accepted. It has spread throughout the business world and is no longer seen as just affecting those sectors where traditionally there have been high profile issues such as oil, chemicals or branded merchandise businesses sourcing their goods from the developing world. Secondly, corporate social responsibility has started to move from the periphery of business to its core, where it is being integrated into business strategy and marketing. Thirdly, there is an increasingly sharp focus on company and sector-specific issues. The ABI report concludes that while all companies face generic risks, it is the specific ones that may present the greater risk or opportunity in many instances. Many of the generic risks are covered in key codes, for example the UN Global Compact and the OECD Guidelines for Multinationals (see Figure 7.2). Examples of sector-specific risks are:

Social exclusion

A major issue for the financial sector in providing banking and insurance services to those on low incomes. It also tends to affect utilities and pharmaceutical groups, the latter as regards access to drugs in the developing world.

Excessive consumption

A failure to discourage customers from consuming too much of their products or services. Alcohol, tobacco and gambling have long been in this category but it has recently been extended to 'unhealthy' – or too much – food and the provision of credit cards.

Fair trade

Traditionally focused on offering a fair price to suppliers of commodities in the developing world, for example tea and coffee. It has now been extended to include relations between, say, UK farmers and major food retailers.

Figure 7.2

Main issues covered by international codes

- **Treatment of employees/workers in the supply chain - embracing diversity, health and safety, pay and conditions, child labour.**
- **Human rights issues - for example torture, political imprisonment, bribery and corruption.**
- **Environmental impacts - including sourcing of materials, product use and disposal.**
- **Community impacts - including support for community organisations and the economic impacts of location decisions.**
- **Transparency - engagement in dialogue and reporting of performance in the above areas.**

Source: ABI, Risk, Returns and Responsibility, 2004

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Engaging with key stakeholders

Companies should engage with their key stakeholders to determine what they regard as the group's principal corporate social responsibility challenges and to understand if they are addressing them. This feedback can then help develop the group's corporate social responsibility agenda – a process that should be led by board members or senior management. Much remains to be done on engagement with stakeholders: less than one in seven of respondents (14%) to the *Board Effectiveness Survey* fully agreed that their board monitors how key stakeholders view their company's corporate social responsibility performance. This was the least positive response, by a wide margin, to any question in the survey. Existing meetings with stakeholder groups – for example, the financial community and employees – can be used to ascertain their views on corporate social responsibility issues. It may also be worth establishing whether those stakeholders with whom the business regularly meets have specific corporate social responsibility representatives. For example, many fund management groups will now have somebody who is permanently focused on these issues. New arrangements should also be made to meet with stakeholder groups that do not have a regular audience with the company. There might be 'one off' meetings or more permanent advisory panels. A merit of cross-stakeholder discussions is that both they and the business can see the 'trade-offs' that will be required in responding to their differing needs. Annual meetings and the corporate website are also useful channels through which to provide information and encourage two-way dialogue on corporate social responsibility issues.

Guidelines

While the Code does not directly refer to corporate social responsibility, it falls squarely within the principle that 'the board should state the company's values and standards and ensure that its obligations to its shareholders and others are met'. Corporate social responsibility will impinge on the application of much of the Code, including risk management, dialogue with institutional shareholders and reporting.

The UK Government is committed to introducing an expanded mandatory Operating and Financial Review (OFR) in the annual report of quoted UK companies in the near future. It will require forward-looking discussion of broader strategic issues. The draft regulations make specific reference to including relevant information on employees, environmental matters and social and community issues. The existing OFR, revised by the Accounting Standards Board in 2003, already calls on companies to discuss the objectives of the business which may include those in the area of corporate responsibility.

The ABI's best practice guidelines [(3)] outline disclosures that institutional investors would look for in the annual reports of listed companies (see Figure 7.3). Their recent report showed that while 80 of the top 100 companies have provided full or moderate disclosure on social, environmental and ethical issues (23% and 57% respectively) less than half of other listed companies have achieved a similar level. For FTSE 250 companies the comparative figures are 2% full and 46% moderate disclosure, while for the FTSE All Share companies only 6% provide full and 35% moderate disclosure. Full disclosure means compliance with the ABI guidelines on social, environmental and ethical issues. This includes defining board and management responsibility in these areas; identifying the relevant risks, their business impact and policies and procedures to deal with them; disclosing performance and targets for quantifiable risks; and some form of internal or external verification or audit.

Another set of respected guidelines has been developed by the Global Reporting Initiative (GRI). Over 600 companies around the world have produced hard-copy corporate social responsibility reports in each of the last two years and about half of them refer to the GRI guidelines. A summary of those guidelines on report content is shown in Figure 7.4.

The UK's Business in the Community (BITC) has also developed a set of indicators, many of which are similar to the GRI guidelines. BITC's *Corporate Responsibility Index* [(4)] rates companies according to their own assessment of their corporate responsibility processes and

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Figure 7.3

ABI disclosure guidelines on socially responsible investment

Board disclosures

The company should state in its annual report whether the board:

- **Takes regular account of the significance of social, environment and ethical (SEE) matters to the business of the company.**
- **Has identified and assessed the significant risks to the company's short and long-term value arising from SEE matters, as well as the opportunities to enhance value that may arise from an appropriate response.**
- **Has received adequate information to make this assessment and that account is taken of SEE matters in the training of directors.**
- **Has ensured that the company has effective systems in place for managing significant risks. Where relevant, these should incorporate performance management systems and appropriate remuneration incentives.**

Policies, procedures and verification

The annual report should:

- **Include information on SEE-related risks and opportunities that may significantly affect the company's short and long term value and how they might impact on the business.**
- **Describe the company's policies and procedures for managing risks to short and long-term value arising from SEE matters.**
- **Include information about the extent to which the company has complied with its policies and procedures for managing SEE risks.**
- **Describe the procedures for verification of SEE disclosures. They should be such as to achieve a reasonable level of credibility.**

Source: ABI, Disclosure Guidelines on Socially Responsible Investment, 2001 (abridged)

performance. The *Corporate Responsibility Index* has been designed to promote a systematic approach to measuring, managing, and reporting the various impacts that companies have upon society and their environment. The latest results from over 130 participating companies [(4)] suggest that the majority are looking at corporate responsibility issues across their businesses. However, the integration of responsible business practice across operations is less advanced than the development of corporate strategy in this area. Likewise, corporate social responsibility is being considered as part of the risk evaluation process but further engagement of external stakeholders is required. Four out of five of the participating companies have a board director with explicit responsibility for human rights but many need to focus on educating and training their staff to ensure their codes of business behaviour are being implemented in practice.

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Figure 7.4

GRI reporting guidelines: suggested content of sustainability report

Vision and strategy – **description of the reporting organisation's strategy with regard to sustainability, including a statement from the CEO.**

Profile – **overview of the reporting organisation's structure and operations. Also to include the scope of the report.**

Governance structure and management systems – **description of organisational structure, policies and management systems, including stakeholder engagement efforts.**

GRI content index – **a table supplied by the reporting organisation identifying where the information listed in Part C of the Guidelines is located within the organisation's report. Part C covers direct economic, environmental and social impacts (labour practices, human rights, society and product liability).**

Performance indicators – **measure of the impact or effect of the reporting organisation divided into integrated economic, environmental and social performance indicators.**

Source: Global Reporting Initiative, GRI Reporting Guidelines, 2002 [6]

A balancing act

The World Economic Forum report referred to at the beginning of this chapter points out that balancing long-term goals with short-term imperatives and managing and accounting for a plethora of non-traditional risks and opportunities calls for new leadership skills and new approaches to communication. It also calls for new types of co-operation. Investors and corporations can do much to work together in a manner that makes sound business sense while also increasing our common ability to manage risk and promote sustainable prosperity.

References

(1) *World Economic Forum, Values and Value, Findings of a 2003 CEO Survey of the World Economic Forum Global Corporate Citizenship Initiative in partnership with The Prince of Wales International Business Leaders Forum, 2004*

(2) *Association of British Insurers, Risks, Returns and Responsibility, 2004*

(3) *Association of British Insurers, Disclosure Guidelines on Socially Responsible Investment, 2001*

(4) *Business in the Community, Corporate Responsibility Index, 2003 (bitc.org.uk/docs/2nd_Corporate_Responsibility_Index_Executive_Summary.pdf)*

(5) *Nelson J. et al, The Power to Change: Mobilising board leadership to deliver sustainable value to markets and society, The Prince of Wales International Business Leaders Forum and Sustainability, 2001*

(6) *Global Reporting Initiative, GRI Reporting Guidelines, 2002*

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An active dialogue with shareholders

- How effective is the company's investor relations programme in developing two-way dialogue with institutional investors, private investors and analysts? How could it be enhanced?
- Is the board fully aware of institutional investors' views of the strategy and performance of the group and of the quality of its management/board?
- Does the company thoroughly evaluate its investor relations performance?
- Have new investors been identified and targeted for meetings?
- Are there procedures in place to manage relationships with shareholders in the event of a crisis?
- How satisfactory is the amount and content of company coverage in the financial media? What improvements could be made in this area?
- Do the annual report/AGM/website meet the needs of users and accord with best practice?

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An active dialogue with shareholders

Less than half the respondents to the *Board Effectiveness Survey* – just 47% – said that their board has a complete understanding of investors' expectations of the company and how they perceive its performance. It is therefore timely that the new Code has enhanced coverage on maintaining an effective two-way dialogue with institutional shareholders. Indeed, it is particularly apt given the growing willingness of institutional investors to express concern actively when they feel the situation demands it.

Dialogue with institutional shareholders

Institutional shareholders include insurance companies, life assurance companies, pension funds, investment trusts and other investment management groups. As a group, they are significant shareholders in many listed companies including all larger ones. In some smaller listed companies, a handful of institutions sometimes hold a very significant proportion of the shares. Where hedge funds have an interest in a company's shares this may introduce an element of volatility through the buying and selling of large tranches of shares in a relatively short period.

The Code stresses that there should be a dialogue with shareholders based on a mutual understanding of objectives. The board as a whole is given the responsibility for ensuring that the dialogue is satisfactory. The Code acknowledges that most shareholder contact will be with the CEO and finance director but says that the chairman should maintain sufficient contact to understand issues and concerns. He or she should also be in a position to discuss governance and strategy matters with investors and feed their views back to the board. In addition, the senior independent director should attend sufficient meetings so that he or she, like the chairman, can develop a balanced understanding of the issues and concerns of the major shareholders. Non-executive directors should be offered the opportunity to attend meetings with major shareholders and are expected to do so if shareholders request a meeting.

Added together, these provisions make it much more difficult for any institutional shareholder concerns not to be known by the chairman and independent directors. The Code also states that the annual report should set out the steps taken to ensure the board and, in particular the non-executive directors, develop an understanding of major shareholders' views of their company. This may be achieved through a range of approaches, including face-to-face meetings, analysts' or brokers' briefings and surveys of shareholders' opinions.

Getting to know your major shareholders

Boards should gain an understanding of each of their major institutional shareholders and, where there is a fund manager representing them, the mandate(s) under which they manage the shares. This knowledge will give an invaluable insight into the likelihood of those investors holding the shares for the longer term. Fund managers whose performance is judged over a period of years rather than by reference to quarterly returns on their portfolio are, for example, less likely to be regularly trading the shares they manage. Similarly, tracker funds will be required to hold shares across all of a given index.

It will be helpful for the board to understand how their institutional shareholders monitor their holdings and approach governance issues. Some institutions employ a screening system based on financial performance and then look at the root cause of a problem, for example in strategy or governance, when performance falls below a specified financial benchmark. Others will follow up governance concerns irrespective of the strength of current financial performance and some will act on issues of strategic importance, say risk management. In such instances it is common to look at how well the matter is dealt with across a particular business sector in order to make comparisons with a peer group.

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Despite the undoubted differences in approach, certain common themes do emerge among institutional investors and fund managers:

- Institutional investors and their fund managers do not want to micro-manage their investments but do want assurance that the board is actively directing and leading the company and they want to know that it is well managed.
- They want a company's board to have a clear strategy that it is able to articulate and deliver.
- Companies need to have a clear understanding of the principal risks that need to be managed if the business is to achieve its objectives.
- Remuneration packages should be genuinely aligned with shareholders' interests. There is a willingness to see outstanding performance well rewarded but concern that in some instances average, or slightly above average, performance has been attracting high payouts. There is also strong interest in making sure failure is not rewarded – investors will generally be suffering losses or low returns when this happens.
- Frustration exists at the amount of 'boilerplate', that is detailed but bland, disclosure in annual reports, especially in areas such as governance and risk management. This is coupled with an affirmation of the importance of the annual report and a desire for effective accountability and communication through it as to how the company is performing, how it is governed and how it is addressing the challenges it faces.
- There is a willingness, especially in the case of smaller listed companies, to accept some departures from the Code and not to treat them as breaches of good corporate governance. However, in such instances the companies are expected to provide clear justification for their actions.

Boards should take the above points into account and make sure that they are aware of the views of their major shareholders on issues such as strategy, performance, quality of leadership and boardroom remuneration. In certain instances, such as the appointment of a new chairman or CEO, they would be well advised to sound out the views of those investors in advance. As well as considering the views of current institutional shareholders, it can sometimes be worth talking to potential investors in order to obtain an alternative view. In the case of a larger listed company, potential investors might include any major institution that is unexpectedly light in its

Figure 8.1

Circumstances when institutional shareholders/agents may intervene

Intervention may occur in response to concern about:

- **strategy;**
- **operational performance;**
- **acquisition/disposal strategy;**
- **independent directors not holding executive management properly to account;**
- **internal controls failing;**
- **inadequate succession planning;**
- **unjustifiable failure to comply with the Combined Code;**
- **inappropriate remuneration levels/incentive packages/severance packages;**
- **a poor approach to corporate social responsibility.**

Source: Institutional Shareholders' Committee, The Responsibilities of Institutional Shareholders and Agents - Statement of Principles, 2002 (abridged)

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Figure 8.2
Possible forms of intervention by institutional shareholders/agents

- **holding additional meetings with management**
- **expressing concern through the company's advisers**
- **meeting with the chairman, senior independent director, all independent directors**
- **intervening jointly with other institutions**
- **making a public statement in advance of an AGM/EGM**
- **submitting resolutions at shareholders' meetings**
- **requisitioning an EGM, possibly to change the board**

Source: Institutional Shareholders' Committee, The Responsibilities of Institutional Shareholders and Agents - Statement of Principles, 2002 (abridged)

holdings. The board should also keep up to date with financial, trade and other press coverage of the company together with the current range of views on the company's outlook in brokers' notes.

Large institutional shareholders will want direct contact with the company through presentations and one-to-one meetings. Subject to adhering to the requirements concerning the release of price-sensitive information, there should be a regular flow of information to the market with management available to respond to investors' questions after key announcements have been made. For example, after the announcement of preliminary results to the market at 7.00 am through a Primary Information Provider (PIP) there should normally be a range of follow-up presentations and meetings that day. Some companies will also follow these initial meetings with a roadshow to see other investors.

In addition to meetings with institutional shareholders, companies often arrange separate meetings with analysts. At all these events, they should make sure that they communicate their strategy and competitive strengths clearly and succinctly. Many companies also use site visits to provide investors and analysts with a greater insight into their business, to demonstrate new products and to allow them to meet other members of the senior management team.

The Institutional Shareholders Committee [1] has indicated the circumstances in which institutions may wish to discuss their concerns with an investee company (see Figure 8.1). Its Statement of Principles goes on to outline the escalating form that such interaction may take depending on the response received (see Figure 8.2). The Committee has also set out the information available to companies from institutional investors – companies will find it helpful to obtain this both with respect to current and potential institutional shareholders (see Figure 8.3).

Foreign institutional ownership forms a growing element of the UK market and companies should ensure that the needs of their overseas shareholders are not overlooked. Market information should be made available to a global audience via the web or other forms of electronic distribution. Many companies are now making presentations of their results through conference calls and web casts allowing easy access regardless of location. Companies with an increasingly international shareholder base should make sure that they visit their overseas investors on a regular basis as well as actively inviting those institutions to domestic investor events.

Private investors

The Code focuses primarily on institutional investors but companies should be careful not to overlook private investors when organising their investor relations activities. Private investors can be especially important to smaller listed companies who may find it difficult to attract an institutional following. They can also be a very

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loyal group of shareholders, with many relying on press comment and company communications for information on their holdings. On the downside, the cost per share of maintaining private investors on the share register, including sending them relevant information, can be much higher than for institutional counterparts because of their smaller average shareholdings.

Smaller listed companies may find it helpful to develop links with private client brokers in their areas in order to build a strong local following from private investors. Such moves can also be enhanced by developing good links with the regional financial press. Some companies seek to attract private investors by offering discounts on their products or services. Shareholder 'perks' such as these have proved a reliable way of building a following in the past in some instances but care needs to be taken that the cost of the discount remains reasonable.

Attracting institutional interest

There is no ideal balance on the shareholder register between institutional and private shareholders. It will depend on the company's circumstances including the current mix of shareholders the resources available to target new investors and whether the board wishes to source new capital in the near future.

Many smaller listed companies express concern about not being able to attract an institutional investor following. Without institutional interest, smaller company shares can suffer from low liquidity meaning that moderate share purchases or sales leads to volatility in the share price. There is no easy solution but the following may help in increasing institutional interest:

- ensure a sufficient ‘free float’ of shares so that there is a reasonable possibility of liquidity in the market;
- ensure the company is seen to be well governed with a skilled management team and well respected non-executive directors (where a family business, it will be important to persuade the market that directors are selected on grounds of merit);
- develop a credible strategy that offers significant potential for the company – growth is the main reason for institutional investors or their fund managers to take an interest in smaller listed companies;
- generate interest among analysts in the company, if possible securing it from analysts independent of the company’s broker, ideally accompanied by published research;
- develop links with financial journalists, whether national, regional or from the trade press, and project the company in a way that targets the selected journalists’ special interests; and
- follow the cardinal rule of not surprising the market, especially not with negative news.

Figure 8.3

Information available from institutional shareholders and their agents

A clear, publicly available policy statement on their approach to activism and how they will discharge their responsibilities including on issues set out below:

- **How investee companies will be monitored**
- **The policy on compliance with the Combined Code**
- **The policy for meeting with an investee’s board and senior management**
- **How they will deal with situations where institutional shareholders/agents have a conflict**
- **Strategy on intervention**
- **Indication of circumstances when further action will be taken and possible types of action**
- **Voting policy**

Source: Institutional Shareholders’ Committee, The Responsibilities of Institutional Shareholders and Agents - Statement of Principles, 2002 (abridged)

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IR website

An investor relations website is a cost-effective way of providing easily-updated information at all times to all locations. It can also be accessed by all of a company's audiences. While it is not a substitute for the regulatory requirement of keeping the market informed through press releases via the PIP system, it can be an added communications channel providing access to investor presentations, analysts' meetings and site tours. E-mail alerts can also be used to send up-to-date news to investors and other interested parties.

Good IR websites should be a mixture of a briefing tool for those coming to the company for the first time; an ongoing information service for those with an established interest in it and an electronic library of corporate information. They also help to create a more level playing-field between institutional and private investors – the web grants all investors access to financial information as it is released. An indication of best practice website content suggested by the Investor Relations Society is shown in Figure 8.4.

Measuring IR performance

Like all other parts of the business, the return on the time and cost invested in the investor relations programme should be measured and managed. It is hard to gauge precisely the impact of an investor relations programme since it will ultimately be determined by its effect on the share price and increased interest in the company's stock. It may, for instance, have the effect of allowing the company to raise new capital on more competitive terms but, once again, it is difficult to compare before and after in such instances.

Notwithstanding this, it will be helpful to set measurable objectives. These might include:

- setting targets for the number of analysts and institutional investors to be visited in the year. The latter group could be broken down further into existing and potential investors;
- checking the amount and quality of coverage in national, regional and trade media;
- reviewing the number of analysts' research reports written on the company and the degree of support they show for the company's strategy, leadership and performance; and
- assessing whether the shareholder register moves in the desired direction over time, for example in terms of greater institutional involvement.

Promoting ongoing dialogue with institutions

Boards will find that investing time and resources into having an open, ongoing dialogue with current – and potential – institutional shareholders will more than justify the cost. A critical element of this dialogue will involve listening carefully to messages being relayed back to the board. Sometimes this may come indirectly through, say, an investor relations officer or agency but any feedback is to be ignored at the company's peril. A quality, ongoing dialogue with investors will put the company on the front foot rather than force it to spend time justifying or reversing decisions that have failed to command support. Communication will also help to build a high level of trust and understanding in the relationship between the board and investors. Current and prospective shareholders not only supply the company's capital – they also determine its value.

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Figure 8.4

IR best practice - site content

General

- A clear statement of strategy and vision.
- Corporate profile including analysis of the company's principal markets.

Financial Data

- Annual Report, interim, preliminary and quarterly statements.
- Archived financial information for a minimum of three years. Five to ten years history of key P&L data.
- Key financial ratios should be on the site – including return on capital employed or return on net assets, cash flow per share, discounted cash flow per share, earnings per share, updated P/E ratios and margin information.
- Relevant information on the main intangibles of the business, for example, brands and human capital.

Corporate governance & corporate social responsibility (CSR)

- Information related to application of/compliance with the Combined Code.
- Comprehensive information on the company's CSR policies including the policy objectives for each CSR area with quantified progress towards their achievement. A note of any pending litigation on health and safety/other socially responsible investment matters.

Shareholder information

- Shareholding analysis by size and constituent. Details of percentage shareholding of principal shareholders.
- AGM reporting, including votes for and against each resolution.
- Information on directors' share dealings.
- Brokers' consensus earnings forecasts and a list of analysts covering the company's stock.

Relevant news

- Access to all news releases and to presentations, speeches, reports and articles by key executives.
- Access to electronic filings, for example those filing with SEC using the EDGAR system.
- Identification of financial sites carrying specific company data.

Source: Investor Relations Society website – best practice section

References

(1) Institutional Shareholders Committee, The Responsibilities of Institutional Shareholders and Agents – Statement of Principles, 2002

(2) Investor Relations Society website – best practice section

This chapter also draws on advice contained in 'Investor Relations – A Practical Guide' published by the London Stock Exchange and Buchanan Communications

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Online resource centre

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Association of British Insurers www.abi.org.uk

The investment affairs section contains the ABI's *Corporate Governance Guidelines on Executive Compensation* and *Share Based Remuneration*, Corporate *Governance and Social Responsibility* as well as the Institutional Shareholders' Committee statement on the *Responsibilities of Institutional Shareholders and Agents – Statement of Principles*.

Business in the Community www.bitc.org.uk

The resources section contains a toolkit, updates on developments in the responsible business practice agenda and details on their *Corporate Responsibility Index* and *Corporate Reporting Impact Initiative.*

CBI www.cbi.org.uk

The website includes CSR case studies which are updated each quarter.

Conference Board www.conference-board.org

Details are included on a number of reports and briefings on boardroom issues, principally from a US perspective, including *Corporate Governance Best Practices, A Blueprint for the Post-Enron Era.*

Department of Trade and Industry www.dti.gov.uk

Resources include research data on listed company boards (produced as part of the *Higgs Report*), the *Director's Remuneration Report Regulations*, the *Accounting for People* report and guidance on corporate social responsibility.

Financial Reporting Council www.frc.org.uk

The FRC website contains the *Combined Code on Corporate Governance.* The related Accounting Standards Board and Auditing Practices Board websites can also be accessed from here.

Global Reporting Initiative www.globalreporting.org

The website includes information on the *GRI Reporting Framework* covering the latest guidelines, technical protocols, sector supplements and details on organisations using the guidelines.

Institute of Chartered Accountants in England and Wales www.icaew.co.uk

The Institute's series of booklets on audit committees can be downloaded from the corporate governance area of the technical policy section of the website.

Institute of Internal Auditors www.iia.org.uk

The website includes a useful briefing for the audit committee on *Appraising Internal Audit* and a benchmark audit charter setting out the purpose, responsibilities and powers of the internal audit department.

Investor Relations Society www.ir-soc.org.uk

The IR best practice section of the website contains comprehensive guidelines on best practice in online investor relations.

London Stock Exchange
www.londonstockexchange.com

Providing a comprehensive guide to the London Stock Exchange and an important source of information, amongst other things, on how companies can maximise the benefit of being on one of our markets. The Practical Guide series can be ordered through the Exchange website.

National Association of Pension Funds
www.napf.co.uk

The website includes details on the NAPF's 2004 *Corporate Governance Policy* which provides the framework for the NAPF's voting guidelines.

RSM Robson Rhodes LLP www.rsmi.co.uk

The RSM Robson Rhodes website contains a number of corporate governance resources including the results of the *Board Effectiveness Survey* and of the *Investment Trust Board Effectiveness Survey* as well as a downloadable version of the RSM International publication *Building World Class Boards* . A copy of Malcolm McKenzie's lecture to the Institution of Mechanical Engineers on strategic issues can also be downloaded from the website.

World Economic Forum www.weforum.org

Contains information on a number of initiatives including *Corporate Governance Dialogue* and *Global Corporate Citizenship.* The latter section contains the report *'Values and Value, Communicating the Importance of Corporate Citizenship to Investors'.*

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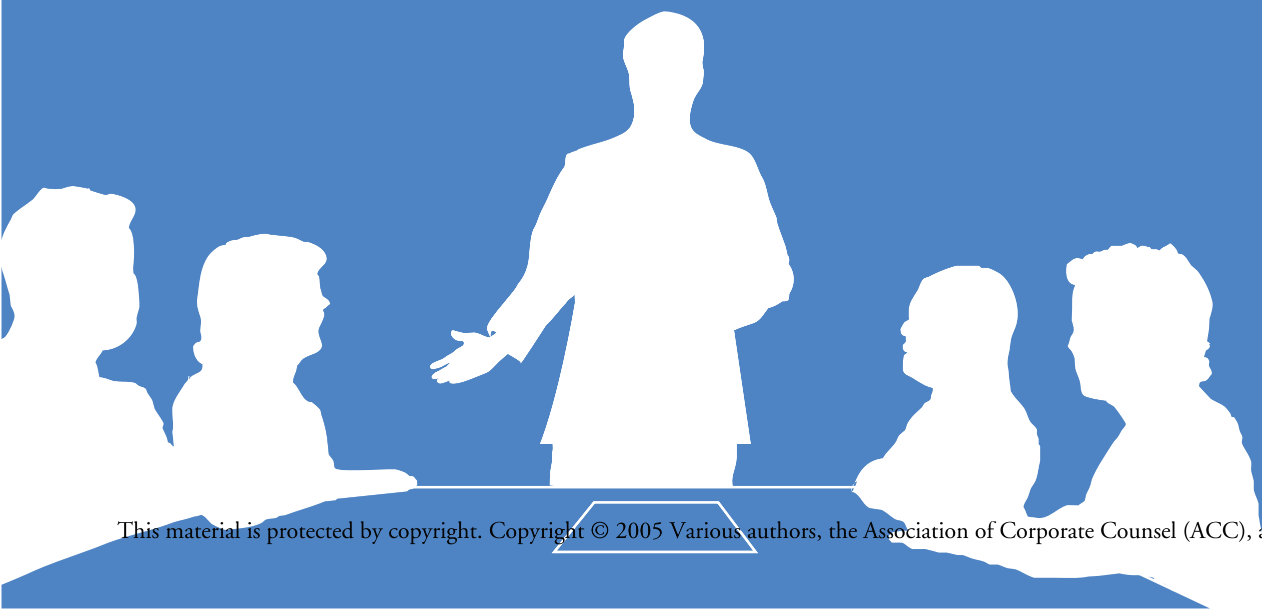

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COUNCIL DIRECTIVE 2001/86/EC

of 8 October 2001

supplementing the Statute for a European company with regard to the involvement of employees

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 308 thereof,

Having regard to the amended proposal from the Commission [1],

Having regard to the opinion of the European Parliament [2],

Having regard to the opinion of the Economic and Social Committee [3],

Whereas:

(1) In order to attain the objectives of the Treaty, Council Regulation (EC) No 2157/2001 [4] establishes a Statute for a European company (SE).

(2) That Regulation aims at creating a uniform legal framework within which companies from different Member States should be able to plan and carry out the reorganisation of their business on a Community scale.

(3) In order to promote the social objectives of the Community, special provisions have to be set, notably in the field of employee involvement, aimed at ensuring that the establishment of an SE does not entail the disappearance or reduction of practices of employee involvement existing within the companies participating in the establishment of an SE. This objective should be pursued through the establishment of a set of rules in this field, supplementing the provisions of the Regulation.

(4) Since the objectives of the proposed action, as outlined above, cannot be sufficiently achieved by the Member States, in that the object is to establish a set of rules on employee involvement applicable to the SE, and can therefore, by reason of the scale and impact of the proposed action, be better achieved at Community level, the Community may adopt measures, in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty. In accordance with the principle of proportionality, as set out in that Article, this Directive does not go beyond what is necessary to achieve these objectives.

(5) The great diversity of rules and practices existing in the Member States as regards the manner in which employees' representatives are involved in decision-making within companies makes it inadvisable to set up a single European model of employee involvement applicable to the SE.

(6) Information and consultation procedures at transnational level should nevertheless be ensured in all cases of creation of an SE.

(7) If and when participation rights exist within one or more companies establishing an SE, they should be preserved through their transfer to the SE, once established, unless the parties decide otherwise.

(8) The concrete procedures of employee transnational information and consultation, as well as, if applicable, participation, to apply to each SE should be defined primarily by means of an agreement between the parties concerned or, in the absence thereof, through the application of a set of subsidiary rules.

(9) Member States should still have the option of not applying the standard rules relating to participation in the case of a merger, given the diversity of national systems for employee involvement. Existing systems and practices of participation where appropriate at the level of participating companies must in that case be maintained by adapting registration rules.

(10) The voting rules within the special body representing the employees for negotiation purposes, in particular when concluding agreements providing for a level of participation lower than the one existing within one or more of the participating companies, should be proportionate to the risk of disappearance or reduction of existing systems and practices of participation. That

[1] OJ C 138, 29.5.1991, p. 8.
[2] OJ C 342, 20.12.1993, p. 15.
[3] OJ C 124, 21.5.1990, p. 34.
[4] See page 1 of this Official Journal.

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risk is greater in the case of an SE established by way of transformation or merger than by way of creating a holding company or a common subsidiary.

(11) In the absence of an agreement subsequent to the negotiation between employees' representatives and the competent organs of the participating companies, provision should be made for certain standard requirements to apply to the SE, once it is established. These standard requirements should ensure effective practices of transnational information and consultation of employees, as well as their participation in the relevant organs of the SE if and when such participation existed before its establishment within the participating companies.

(12) Provision should be made for the employees' representatives acting within the framework of the Directive to enjoy, when exercising their functions, protection and guarantees which are similar to those provided to employees' representatives by the legislation and/or practice of the country of employment. They should not be subject to any discrimination as a result of the lawful exercise of their activities and should enjoy adequate protection as regards dismissal and other sanctions.

(13) The confidentiality of sensitive information should be preserved even after the expiry of the employees' representatives terms of office and provision should be made to allow the competent organ of the SE to withhold information which would seriously harm, if subject to public disclosure, the functioning of the SE.

(14) Where an SE and its subsidiaries and establishments are subject to Council Directive 94/45/EC of 22 September 1994 on the establishment of a European Works Council or a procedure in Community-scale undertakings and Community-scale groups of undertakings for the purposes of informing and consulting employees [1], the provisions of that Directive and the provision transposing it into national legislation should not apply to it nor to its subsidiaries and establishments, unless the special negotiating body decides not to open negotiations or to terminate negotiations already opened.

(15) This Directive should not affect other existing rights regarding involvement and need not affect other existing representation structures, provided for by Community and national laws and practices.

(16) Member States should take appropriate measures in the event of failure to comply with the obligations laid down in this Directive.

(17) The Treaty has not provided the necessary powers for the Community to adopt the proposed Directive, other than those provided for in Article 308.

(18) It is a fundamental principle and stated aim of this Directive to secure employees' acquired rights as regards involvement in company decisions. Employee rights in force before the establishment of SEs should provide the basis for employee rights of involvement in the SE (the 'before and after' principle). Consequently, that approach should apply not only to the initial establishment of an SE but also to structural changes in an existing SE and to the companies affected by structural change processes.

(19) Member States should be able to provide that representatives of trade unions may be members of a special negotiating body regardless of whether they are employees of a company participating in the establishment of an SE. Member States should in this context in particular be able to introduce this right in cases where trade union representatives have the right to be members of, and to vote in, supervisory or administrative company organs in accordance with national legislation.

(20) In several Member States, employee involvement and other areas of industrial relations are based on both national legislation and practice which in this context is understood also to cover collective agreements at various national, sectoral and/or company levels,

HAS ADOPTED THIS DIRECTIVE:

SECTION I

GENERAL

Article 1

Objective

1. This Directive governs the involvement of employees in the affairs of European public limited-liability companies (*Societas Europaea*, hereinafter referred to as 'SE'), as referred to in Regulation (EC) No 2157/2001.

[1] OJ L 254, 30.9.1994, p. 64. Directive as last amended by Directive 97/74/EC (OJ L 10, 16.1.1998, p. 22).

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2. To this end, arrangements for the involvement of employees shall be established in every SE in accordance with the negotiating procedure referred to in Articles 3 to 6 or, under the circumstances specified in Article 7, in accordance with the Annex.

Article 2

Definitions

For the purposes of this Directive:

(a) 'SE' means any company established in accordance with Regulation (EC) No 2157/2001;

(b) 'participating companies' means the companies directly participating in the establishing of an SE;

(c) 'subsidiary' of a company means an undertaking over which that company exercises a dominant influence defined in accordance with Article 3(2) to (7) of Directive 94/45/EC;

(d) 'concerned subsidiary or establishment' means a subsidiary or establishment of a participating company which is proposed to become a subsidiary or establishment of the SE upon its formation;

(e) 'employees' representatives' means the employees' representatives provided for by national law and/or practice;

(f) 'representative body' means the body representative of the employees set up by the agreements referred to in Article 4 or in accordance with the provisions of the Annex, with the purpose of informing and consulting the employees of an SE and its subsidiaries and establishments situated in the Community and, where applicable, of exercising participation rights in relation to the SE;

(g) 'special negotiating body' means the body established in accordance with Article 3 to negotiate with the competent body of the participating companies regarding the establishment of arrangements for the involvement of employees within the SE;

(h) 'involvement of employees' means any mechanism, including information, consultation and participation, through which employees' representatives may exercise an influence on decisions to be taken within the company;

(i) 'information' means the informing of the body representative of the employees and/or employees' representatives by the competent organ of the SE on questions which concern the SE itself and any of its subsidiaries or establishments situated in another Member State or which exceed the powers of the decision-making organs in a single Member State at a time, in a manner and with a content which allows the employees' representatives to undertake an in-depth assessment of the possible impact and, where appropriate, prepare consultations with the competent organ of the SE;

(j) 'consultation' means the establishment of dialogue and exchange of views between the body representative of the employees and/or the employees' representatives and the competent organ of the SE, at a time, in a manner and with a content which allows the employees' representatives, on the basis of information provided, to express an opinion on measures envisaged by the competent organ which may be taken into account in the decision-making process within the SE;

(k) 'participation' means the influence of the body representative of the employees and/or the employees' representatives in the affairs of a company by way of:

— the right to elect or appoint some of the members of the company's supervisory or administrative organ, or

— the right to recommend and/or oppose the appointment of some or all of the members of the company's supervisory or administrative organ.

SECTION II

NEGOTIATING PROCEDURE

Article 3

Creation of a special negotiating body

1. Where the management or administrative organs of the participating companies draw up a plan for the establishment of an SE, they shall as soon as possible after publishing the draft terms of merger or creating a holding company or after agreeing a plan to form a subsidiary or to transform into an SE, take the necessary steps, including providing information about the identity of the participating companies, concerned subsidiaries or establishments, and the number of their employees, to start negotiations with the representatives of the companies' employees on arrangements for the involvement of employees in the SE.

2. For this purpose, a special negotiating body representative of the employees of the participating companies and concerned subsidiaries or establishments shall be created in accordance with the following provisions:

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(a) in electing or appointing members of the special negotiating body, it must be ensured:

(i) that these members are elected or appointed in proportion to the number of employees employed in each Member State by the participating companies and concerned subsidiaries or establishments, by allocating in respect of a Member State one seat per portion of employees employed in that Member State which equals 10 %, or a fraction thereof, of the number of employees employed by the participating companies and concerned subsidiaries or establishments in all the Member States taken together;

(ii) that in the case of an SE formed by way of merger, there are such further additional members from each Member State as may be necessary in order to ensure that the special negotiating body includes at least one member representing each participating company which is registered and has employees in that Member State and which it is proposed will cease to exist as a separate legal entity following the registration of the SE, in so far as:

— the number of such additional members does not exceed 20 % of the number of members designated by virtue of point (i), and

— the composition of the special negotiating body does not entail a double representation of the employees concerned.

If the number of such companies is higher than the number of additional seats available pursuant to the first subparagraph, these additional seats shall be allocated to companies in different Member States by decreasing order of the number of employees they employ;

(b) Member States shall determine the method to be used for the election or appointment of the members of the special negotiating body who are to be elected or appointed in their territories. They shall take the necessary measures to ensure that, as far as possible, such members shall include at least one member representing each participating company which has employees in the Member State concerned. Such measures must not increase the overall number of members.

Member States may provide that such members may include representatives of trade unions whether or not they are employees of a participating company or concerned subsidiary or establishment.

Without prejudice to national legislation and/or practice laying down thresholds for the establishing of a representative body, Member States shall provide that employees in undertakings or establishments in which there are no employees' representatives through no fault of their own have the right to elect or appoint members of the special negotiating body.

3. The special negotiating body and the competent organs of the participating companies shall determine, by written agreement, arrangements for the involvement of employees within the SE.

To this end, the competent organs of the participating companies shall inform the special negotiating body of the plan and the actual process of establishing the SE, up to its registration.

4. Subject to paragraph 6, the special negotiating body shall take decisions by an absolute majority of its members, provided that such a majority also represents an absolute majority of the employees. Each member shall have one vote. However, should the result of the negotiations lead to a reduction of participation rights, the majority required for a decision to approve such an agreement shall be the votes of two thirds of the members of the special negotiating body representing at least two thirds of the employees, including the votes of members representing employees employed in at least two Member States,

— in the case of an SE to be established by way of merger, if participation covers at least 25 % of the overall number of employees of the participating companies, or

— in the case of an SE to be established by way of creating a holding company or forming a subsidiary, if participation covers at least 50 % of the overall number of employees of the participating companies.

Reduction of participation rights means a proportion of members of the organs of the SE within the meaning of Article 2(k), which is lower than the highest proportion existing within the participating companies.

5. For the purpose of the negotiations, the special negotiating body may request experts of its choice, for example representatives of appropriate Community level trade union organisations, to assist it with its work. Such experts may be present at negotiation meetings in an advisory capacity at the request of the special negotiating body, where appropriate to promote coherence and consistency at Community level. The special negotiating body may decide to inform the representatives of appropriate external organisations, including trade unions, of the start of the negotiations.

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6. The special negotiating body may decide by the majority set out below not to open negotiations or to terminate negotiations already opened, and to rely on the rules on information and consultation of employees in force in the Member States where the SE has employees. Such a decision shall stop the procedure to conclude the agreement referred to in Article 4. Where such a decision has been taken, none of the provisions of the Annex shall apply.

The majority required to decide not to open or to terminate negotiations shall be the votes of two thirds of the members representing at least two thirds of the employees, including the votes of members representing employees employed in at least two Member States.

In the case of an SE established by way of transformation, this paragraph shall not apply if there is participation in the company to be transformed.

The special negotiating body shall be reconvened on the written request of at least 10 % of the employees of the SE, its subsidiaries and establishments, or their representatives, at the earliest two years after the abovementioned decision, unless the parties agree to negotiations being reopened sooner. If the special negotiating body decides to reopen negotiations with the management but no agreement is reached as a result of those negotiations, none of the provisions of the Annex shall apply.

7. Any expenses relating to the functioning of the special negotiating body and, in general, to negotiations shall be borne by the participating companies so as to enable the special negotiating body to carry out its task in an appropriate manner.

In compliance with this principle, Member States may lay down budgetary rules regarding the operation of the special negotiating body. They may in particular limit the funding to cover one expert only.

Article 4

Content of the agreement

1. The competent organs of the participating companies and the special negotiating body shall negotiate in a spirit of cooperation with a view to reaching an agreement on arrangements for the involvement of the employees within the SE.

2. Without prejudice to the autonomy of the parties, and subject to paragraph 4, the agreement referred to in paragraph 1 between the competent organs of the participating companies and the special negotiating body shall specify:

(a) the scope of the agreement;

(b) the composition, number of members and allocation of seats on the representative body which will be the discussion partner of the competent organ of the SE in connection with arrangements for the information and consultation of the employees of the SE and its subsidiaries and establishments;

(c) the functions and the procedure for the information and consultation of the representative body;

(d) the frequency of meetings of the representative body;

(e) the financial and material resources to be allocated to the representative body;

(f) if, during negotiations, the parties decide to establish one or more information and consultation procedures instead of a representative body, the arrangements for implementing those procedures;

(g) if, during negotiations, the parties decide to establish arrangements for participation, the substance of those arrangements including (if applicable) the number of members in the SE's administrative or supervisory body which the employees will be entitled to elect, appoint, recommend or oppose, the procedures as to how these members may be elected, appointed, recommended or opposed by the employees, and their rights;

(h) the date of entry into force of the agreement and its duration, cases where the agreement should be renegotiated and the procedure for its renegotiation.

3. The agreement shall not, unless provision is made otherwise therein, be subject to the standard rules referred to in the Annex.

4. Without prejudice to Article 13(3)(a), in the case of an SE established by means of transformation, the agreement shall provide for at least the same level of all elements of employee involvement as the ones existing within the company to be transformed into an SE.

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Article 5

Duration of negotiations

1. Negotiations shall commence as soon as the special negotiating body is established and may continue for six months thereafter.

2. The parties may decide, by joint agreement, to extend negotiations beyond the period referred to in paragraph 1, up to a total of one year from the establishment of the special negotiating body.

Article 6

Legislation applicable to the negotiation procedure

Except where otherwise provided in this Directive, the legislation applicable to the negotiation procedure provided for in Articles 3 to 5 shall be the legislation of the Member State in which the registered office of the SE is to be situated.

Article 7

Standard rules

1. In order to achieve the objective described in Article 1, Member States shall, without prejudice to paragraph 3 below, lay down standard rules on employee involvement which must satisfy the provisions set out in the Annex.

The standard rules as laid down by the legislation of the Member State in which the registered office of the SE is to be situated shall apply from the date of the registration of the SE where either:

(a) the parties so agree; or

(b) by the deadline laid down in Article 5, no agreement has been concluded, and:

— the competent organ of each of the participating companies decides to accept the application of the standard rules in relation to the SE and so to continue with its registration of the SE, and

— the special negotiating body has not taken the decision provided in Article 3(6).

2. Moreover, the standard rules fixed by the national legislation of the Member State of registration in accordance with part 3 of the Annex shall apply only:

(a) in the case of an SE established by transformation, if the rules of a Member State relating to employee participation in the administrative or supervisory body applied to a company transformed into an SE;

(b) in the case of an SE established by merger:

— if, before registration of the SE, one or more forms of participation applied in one or more of the participating companies covering at least 25 % of the total number of employees in all the participating companies, or

— if, before registration of the SE, one or more forms of participation applied in one or more of the participating companies covering less than 25 % of the total number of employees in all the participating companies and if the special negotiating body so decides,

(c) in the case of an SE established by setting up a holding company or establishing a subsidiary:

— if, before registration of the SE, one or more forms of participation applied in one or more of the participating companies covering at least 50 % of the total number of employees in all the participating companies; or

— if, before registration of the SE, one or more forms of participation applied in one or more of the participating companies covering less than 50 % of the total number of employees in all the participating companies and if the special negotiating body so decides.

If there was more than one form of participation within the various participating companies, the special negotiating body shall decide which of those forms must be established in the SE. Member States may fix the rules which are applicable in the absence of any decision on the matter for an SE registered in their territory. The special negotiating body shall inform the competent organs of the participating companies of any decisions taken pursuant to this paragraph.

3. Member States may provide that the reference provisions in part 3 of the Annex shall not apply in the case provided for in point (b) of paragraph 2.

SECTION III

MISCELLANEOUS PROVISIONS

Article 8

Reservation and confidentiality

1. Member States shall provide that members of the special negotiating body or the representative body, and experts who assist them, are not authorised to reveal any information which has been given to them in confidence.

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The same shall apply to employees' representatives in the context of an information and consultation procedure.

This obligation shall continue to apply, wherever the persons referred to may be, even after the expiry of their terms of office.

2. Each Member State shall provide, in specific cases and under the conditions and limits laid down by national legislation, that the supervisory or administrative organ of an SE or of a participating company established in its territory is not obliged to transmit information where its nature is such that, according to objective criteria, to do so would seriously harm the functioning of the SE (or, as the case may be, the participating company) or its subsidiaries and establishments or would be prejudicial to them.

A Member State may make such dispensation subject to prior administrative or judicial authorisation.

3. Each Member State may lay down particular provisions for SEs in its territory which pursue directly and essentially the aim of ideological guidance with respect to information and the expression of opinions, on condition that, on the date of adoption of this Directive, such provisions already exist in the national legislation.

4. In applying paragraphs 1, 2 and 3, Member States shall make provision for administrative or judicial appeal procedures which the employees' representatives may initiate when the supervisory or administrative organ of an SE or participating company demands confidentiality or does not give information.

Such procedures may include arrangements designed to protect the confidentiality of the information in question.

Article 9

Operation of the representative body and procedure for the information and consultation of employees

The competent organ of the SE and the representative body shall work together in a spirit of cooperation with due regard for their reciprocal rights and obligations.

The same shall apply to cooperation between the supervisory or administrative organ of the SE and the employees' representatives in conjunction with a procedure for the information and consultation of employees.

Article 10

Protection of employees' representatives

The members of the special negotiating body, the members of the representative body, any employees' representatives exercising functions under the information and consultation procedure and any employees' representatives in the supervisory or administrative organ of an SE who are employees of the SE, its subsidiaries or establishments or of a participating company shall, in the exercise of their functions, enjoy the same protection and guarantees provided for employees' representatives by the national legislation and/or practice in force in their country of employment.

This shall apply in particular to attendance at meetings of the special negotiating body or representative body, any other meeting under the agreement referred to in Article 4(2)(f) or any meeting of the administrative or supervisory organ, and to the payment of wages for members employed by a participating company or the SE or its subsidiaries or establishments during a period of absence necessary for the performance of their duties.

Article 11

Misuse of procedures

Member States shall take appropriate measures in conformity with Community law with a view to preventing the misuse of an SE for the purpose of depriving employees of rights to employee involvement or withholding such rights.

Article 12

Compliance with this Directive

1. Each Member State shall ensure that the management of establishments of an SE and the supervisory or administrative organs of subsidiaries and of participating companies which are situated within its territory and the employees' representatives or, as the case may be, the employees themselves abide by the obligations laid down by this Directive, regardless of whether or not the SE has its registered office within its territory.

2. Member States shall provide for appropriate measures in the event of failure to comply with this Directive; in particular they shall ensure that administrative or legal procedures are available to enable the obligations deriving from this Directive to be enforced.

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10.11.2001 EN Official Journal of the European Communities L 294/29

Article 13

Link between this Directive and other provisions

1. Where an SE is a Community-scale undertaking or a controlling undertaking of a Community-scale group of undertakings within the meaning of Directive 94/45/EC or of Directive 97/74/EC [1] extending the said Directive to the United Kingdom, the provisions of these Directives and the provisions transposing them into national legislation shall not apply to them or to their subsidiaries.

However, where the special negotiating body decides in accordance with Article 3(6) not to open negotiations or to terminate negotiations already opened, Directive 94/45/EC or Directive 97/74/EC and the provisions transposing them into national legislation shall apply.

2. Provisions on the participation of employees in company bodies provided for by national legislation and/or practice, other than those implementing this Directive, shall not apply to companies established in accordance with Regulation (EC) No 2157/2001 and covered by this Directive.

3. This Directive shall not prejudice:

(a) the existing rights to involvement of employees provided for by national legislation and/or practice in the Member States as enjoyed by employees of the SE and its subsidiaries and establishments, other than participation in the bodies of the SE;

(b) the provisions on participation in the bodies laid down by national legislation and/or practice applicable to the subsidiaries of the SE.

4. In order to preserve the rights referred to in paragraph 3, Member States may take the necessary measures to guarantee that the structures of employee representation in participating companies which will cease to exist as separate legal entities are maintained after the registration of the SE.

Article 14

Final provisions

1. Member States shall adopt the laws, regulations and administrative provisions necessary to comply with this Directive no later than 8 October 2004, or shall ensure by that date at the latest that management and labour introduce the required provisions by way of agreement, the Member States being obliged to take all necessary steps enabling them at all times to guarantee the results imposed by this Directive. They shall forthwith inform the Commission thereof.

2. When Member States adopt these measures, they shall contain a reference to this Directive or shall be accompanied by such reference on the occasion of their official publication. The methods of making such reference shall be laid down by the Member States.

Article 15

Review by the Commission

No later than 8 October 2007, the Commission shall, in consultation with the Member States and with management and labour at Community level, review the procedures for applying this Directive, with a view to proposing suitable amendments to the Council where necessary.

Article 16

Entry into force

This Directive shall enter into force on the day of its publication in the *Official Journal of the European Communities*.

Article 17

Addressees

This Directive is addressed to the Member States.

Done at Luxembourg, 8 October 2001.

For the Council

The President

L. ONKELINX

(1) OJ L 10, 16.1.1998, p. 22.

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ANNEX

STANDARD RULES

(referred to in Article 7)

Part 1: Composition of the body representative of the employees

In order to achieve the objective described in Article 1, and in the cases referred to in Article 7, a representative body shall be set up in accordance with the following rules.

(a) The representative body shall be composed of employees of the SE and its subsidiaries and establishments elected or appointed from their number by the employees' representatives or, in the absence thereof, by the entire body of employees.

(b) The election or appointment of members of the representative body shall be carried out in accordance with national legislation and/or practice.

Member States shall lay down rules to ensure that the number of members of, and allocation of seats on, the representative body shall be adapted to take account of changes occurring within the SE and its subsidiaries and establishments.

(c) Where its size so warrants, the representative body shall elect a select committee from among its members, comprising at most three members.

(d) The representative body shall adopt its rules of procedure.

(e) The members of the representative body are elected or appointed in proportion to the number of employees employed in each Member State by the participating companies and concerned subsidiaries or establishments, by allocating in respect of a Member State one seat per portion of employees employed in that Member State which equals 10 %, or a fraction thereof, of the number of employees employed by the participating companies and concerned subsidiaries or establishments in all the Member States taken together.

(f) The competent organ of the SE shall be informed of the composition of the representative body.

(g) Four years after the representative body is established, it shall examine whether to open negotiations for the conclusion of the agreement referred to in Articles 4 and 7 or to continue to apply the standard rules adopted in accordance with this Annex.

Articles 3(4) to (7) and 4 to 6 shall apply, *mutatis mutandis*, if a decision has been taken to negotiate an agreement according to Article 4, in which case the term 'special negotiating body' shall be replaced by 'representative body'. Where, by the deadline by which the negotiations come to an end, no agreement has been concluded, the arrangements initially adopted in accordance with the standard rules shall continue to apply.

Part 2: Standard rules for information and consultation

The competence and powers of the representative body set up in an SE shall be governed by the following rules.

(a) The competence of the representative body shall be limited to questions which concern the SE itself and any of its subsidiaries or establishments situated in another Member State or which exceed the powers of the decision-making organs in a single Member State.

(b) Without prejudice to meetings held pursuant to point (c), the representative body shall have the right to be informed and consulted and, for that purpose, to meet with the competent organ of the SE at least once a year, on the basis of regular reports drawn up by the competent organ, on the progress of the business of the SE and its prospects. The local managements shall be informed accordingly.

The competent organ of the SE shall provide the representative body with the agenda for meetings of the administrative, or, where appropriate, the management and supervisory organ, and with copies of all documents submitted to the general meeting of its shareholders.

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The meeting shall relate in particular to the structure, economic and financial situation, the probable development of the business and of production and sales, the situation and probable trend of employment, investments, and substantial changes concerning organisation, introduction of new working methods or production processes, transfers of production, mergers, cut-backs or closures of undertakings, establishments or important parts thereof, and collective redundancies.

(c) Where there are exceptional circumstances affecting the employees' interests to a considerable extent, particularly in the event of relocations, transfers, the closure of establishments or undertakings or collective redundancies, the representative body shall have the right to be informed. The representative body or, where it so decides, in particular for reasons of urgency, the select committee, shall have the right to meet at its request the competent organ of the SE or any more appropriate level of management within the SE having its own powers of decision, so as to be informed and consulted on measures significantly affecting employees' interests.

Where the competent organ decides not to act in accordance with the opinion expressed by the representative body, this body shall have the right to a further meeting with the competent organ of the SE with a view to seeking agreement.

In the case of a meeting organised with the select committee, those members of the representative body who represent employees who are directly concerned by the measures in question shall also have the right to participate.

The meetings referred to above shall not affect the prerogatives of the competent organ.

(d) Member States may lay down rules on the chairing of information and consultation meetings.

Before any meeting with the competent organ of the SE, the representative body or the select committee, where necessary enlarged in accordance with the third subparagraph of paragraph (c), shall be entitled to meet without the representatives of the competent organ being present.

(e) Without prejudice to Article 8, the members of the representative body shall inform the representatives of the employees of the SE and of its subsidiaries and establishments of the content and outcome of the information and consultation procedures.

(f) The representative body or the select committee may be assisted by experts of its choice.

(g) In so far as this is necessary for the fulfilment of their tasks, the members of the representative body shall be entitled to time off for training without loss of wages.

(h) The costs of the representative body shall be borne by the SE, which shall provide the body's members with the financial and material resources needed to enable them to perform their duties in an appropriate manner.

In particular, the SE shall, unless otherwise agreed, bear the cost of organising meetings and providing interpretation facilities and the accommodation and travelling expenses of members of the representative body and the select committee.

In compliance with these principles, the Member States may lay down budgetary rules regarding the operation of the representative body. They may in particular limit funding to cover one expert only.

Part 3: Standard rules for participation

Employee participation in an SE shall be governed by the following provisions

(a) In the case of an SE established by transformation, if the rules of a Member State relating to employee participation in the administrative or supervisory body applied before registration, all aspects of employee participation shall continue to apply to the SE. Point (b) shall apply *mutatis mutandis* to that end.

(b) In other cases of the establishing of an SE, the employees of the SE, its subsidiaries and establishments and/or their representative body shall have the right to elect, appoint, recommend or oppose the appointment of a number of members of the administrative or supervisory body of the SE equal to the highest proportion in force in the participating companies concerned before registration of the SE.

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If none of the participating companies was governed by participation rules before registration of the SE, the latter shall not be required to establish provisions for employee participation.

The representative body shall decide on the allocation of seats within the administrative or supervisory body among the members representing the employees from the various Member States or on the way in which the SE's employees may recommend or oppose the appointment of the members of these bodies according to the proportion of the SE's employees in each Member State. If the employees of one or more Member States are not covered by this proportional criterion, the representative body shall appoint a member from one of those Member States, in particular the Member State of the SE's registered office where that is appropriate. Each Member State may determine the allocation of the seats it is given within the administrative or supervisory body.

Every member of the administrative body or, where appropriate, the supervisory body of the SE who has been elected, appointed or recommended by the representative body or, depending on the circumstances, by the employees shall be a full member with the same rights and obligations as the members representing the shareholders, including the right to vote.

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I

(Acts whose publication is obligatory)

COUNCIL REGULATION (EC) No 2157/2001

of 8 October 2001

on the Statute for a European company (SE)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 308 thereof,

Having regard to the proposal from the Commission [1],

Having regard to the opinion of the European Parliament [2],

Having regard to the opinion of the Economic and Social Committee [3],

Whereas:

(1) The completion of the internal market and the improvement it brings about in the economic and social situation throughout the Community mean not only that barriers to trade must be removed, but also that the structures of production must be adapted to the Community dimension. For that purpose it is essential that companies the business of which is not limited to satisfying purely local needs should be able to plan and carry out the reorganisation of their business on a Community scale.

(2) Such reorganisation presupposes that existing companies from different Member States are given the option of combining their potential by means of mergers. Such operations can be carried out only with due regard to the rules of competition laid down in the Treaty.

(3) Restructuring and cooperation operations involving companies from different Member States give rise to legal and psychological difficulties and tax problems. The approximation of Member States' company law by means of Directives based on Article 44 of the Treaty can overcome some of those difficulties. Such approximation does not, however, release companies governed by different legal systems from the obligation to choose a form of company governed by a particular national law.

(4) The legal framework within which business must be carried on in the Community is still based largely on national laws and therefore no longer corresponds to the economic framework within which it must develop if the objectives set out in Article 18 of the Treaty are to be achieved. That situation forms a considerable obstacle to the creation of groups of companies from different Member States.

(5) Member States are obliged to ensure that the provisions applicable to European companies under this Regulation do not result either in discrimination arising out of unjustified different treatment of European companies compared with public limited-liability companies or in disproportionate restrictions on the formation of a European company or on the transfer of its registered office.

(6) It is essential to ensure as far as possible that the economic unit and the legal unit of business in the Community coincide. For that purpose, provision should be made for the creation, side by side with companies governed by a particular national law, of companies formed and carrying on business under the law created by a Community Regulation directly applicable in all Member States.

(7) The provisions of such a Regulation will permit the creation and management of companies with a European dimension, free from the obstacles arising from the disparity and the limited territorial application of national company law.

(1) OJ C 263, 16.10.1989, p. 41 and OJ C 176, 8.7.1991, p. 1.
(2) Opinion of 4 September 2001 (not yet published in the Official Journal).
(3) OJ C 124, 21.5.1990, p. 34.

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(8) The Statute for a European public limited-liability company (hereafter referred to as 'SE') is among the measures to be adopted by the Council before 1992 listed in the Commission's White Paper on completing the internal market, approved by the European Council that met in Milan in June 1985. The European Council that met in Brussels in 1987 expressed the wish to see such a Statute created swiftly.

(9) Since the Commission's submission in 1970 of a proposal for a Regulation on the Statute for a European public limited-liability company, amended in 1975, work on the approximation of national company law has made substantial progress, so that on those points where the functioning of an SE does not need uniform Community rules reference may be made to the law governing public limited-liability companies in the Member State where it has its registered office.

(10) Without prejudice to any economic needs that may arise in the future, if the essential objective of legal rules governing SEs is to be attained, it must be possible at least to create such a company as a means both of enabling companies from different Member States to merge or to create a holding company and of enabling companies and other legal persons carrying on economic activities and governed by the laws of different Member States to form joint subsidiaries.

(11) In the same context it should be possible for a public limited-liability company with a registered office and head office within the Community to transform itself into an SE without going into liquidation, provided it has a subsidiary in a Member State other than that of its registered office.

(12) National provisions applying to public limited-liability companies that offer their securities to the public and to securities transactions should also apply where an SE is formed by means of an offer of securities to the public and to SEs wishing to utilise such financial instruments.

(13) The SE itself must take the form of a company with share capital, that being the form most suited, in terms of both financing and management, to the needs of a company carrying on business on a European scale. In order to ensure that such companies are of reasonable size, a minimum amount of capital should be set so that they have sufficient assets without making it difficult for small and medium-sized undertakings to form SEs.

(14) An SE must be efficiently managed and properly supervised. It must be borne in mind that there are at present in the Community two different systems for the administration of public limited-liability companies. Although an SE should be allowed to choose between the two systems, the respective responsibilities of those responsible for management and those responsible for supervision should be clearly defined.

(15) Under the rules and general principles of private international law, where one undertaking controls another governed by a different legal system, its ensuing rights and obligations as regards the protection of minority shareholders and third parties are governed by the law governing the controlled undertaking, without prejudice to the obligations imposed on the controlling undertaking by its own law, for example the requirement to prepare consolidated accounts.

(16) Without prejudice to the consequences of any subsequent coordination of the laws of the Member States, specific rules for SEs are not at present required in this field. The rules and general principles of private international law should therefore be applied both where an SE exercises control and where it is the controlled company.

(17) The rule thus applicable where an SE is controlled by another undertaking should be specified, and for this purpose reference should be made to the law governing public limited-liability companies in the Member State in which the SE has its registered office.

(18) Each Member State must be required to apply the sanctions applicable to public limited-liability companies governed by its law in respect of infringements of this Regulation.

(19) The rules on the involvement of employees in the European company are laid down in Directive 2001/86/EC [1], and those provisions thus form an indissociable complement to this Regulation and must be applied concomitantly.

[1] See p. 22 of this Official Journal.

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(20) This Regulation does not cover other areas of law such as taxation, competition, intellectual property or insolvency. The provisions of the Member States' law and of Community law are therefore applicable in the above areas and in other areas not covered by this Regulation.

(21) Directive 2001/86/EC is designed to ensure that employees have a right of involvement in issues and decisions affecting the life of their SE. Other social and labour legislation questions, in particular the right of employees to information and consultation as regulated in the Member States, are governed by the national provisions applicable, under the same conditions, to public limited-liability companies.

(22) The entry into force of this Regulation must be deferred so that each Member State may incorporate into its national law the provisions of Directive 2001/86/EC and set up in advance the necessary machinery for the formation and operation of SEs with registered offices within its territory, so that the Regulation and the Directive may be applied concomitantly.

(23) A company the head office of which is not in the Community should be allowed to participate in the formation of an SE provided that company is formed under the law of a Member State, has its registered office in that Member State and has a real and continuous link with a Member State's economy according to the principles established in the 1962 General Programme for the abolition of restrictions on freedom of establishment. Such a link exists in particular if a company has an establishment in that Member State and conducts operations therefrom.

(24) The SE should be enabled to transfer its registered office to another Member State. Adequate protection of the interests of minority shareholders who oppose the transfer, of creditors and of holders of other rights should be proportionate. Such transfer should not affect the rights originating before the transfer.

(25) This Regulation is without prejudice to any provision which may be inserted in the 1968 Brussels Convention or in any text adopted by Member States or by the Council to replace such Convention, relating to the rules of jurisdiction applicable in the case of transfer of the registered offices of a public limited-liability company from one Member State to another.

(26) Activities by financial institutions are regulated by specific directives and the national law implementing those directives and additional national rules regulating those activities apply in full to an SE.

(27) In view of the specific Community character of an SE, the 'real seat' arrangement adopted by this Regulation in respect of SEs is without prejudice to Member States' laws and does not pre-empt any choices to be made for other Community texts on company law.

(28) The Treaty does not provide, for the adoption of this Regulation, powers of action other than those of Article 308 thereof.

(29) Since the objectives of the intended action, as outlined above, cannot be adequately attained by the Member States in as much as a European public limited-liability company is being established at European level and can therefore, because of the scale and impact of such company, be better attained at Community level, the Community may take measures in accordance with the principle of subsidiarity enshrined in Article 5 of the Treaty. In accordance with the principle of proportionality as set out in the said Article, this Regulation does not go beyond what is necessary to attain these objectives,

HAS ADOPTED THIS REGULATION:

TITLE I

GENERAL PROVISIONS

Article 1

1. A company may be set up within the territory of the Community in the form of a European public limited-liability company (*Societas Europaea* or SE) on the conditions and in the manner laid down in this Regulation.

2. The capital of an SE shall be divided into shares. No shareholder shall be liable for more than the amount he has subscribed.

3. An SE shall have legal personality.

4. Employee involvement in an SE shall be governed by the provisions of Directive 2001/86/EC.

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Article 2

1. Public limited-liability companies such as referred to in Annex I, formed under the law of a Member State, with registered offices and head offices within the Community may form an SE by means of a merger provided that at least two of them are governed by the law of different Member States.

2. Public and private limited-liability companies such as referred to in Annex II, formed under the law of a Member State, with registered offices and head offices within the Community may promote the formation of a holding SE provided that each of at least two of them:

(a) is governed by the law of a different Member State, or

(b) has for at least two years had a subsidiary company governed by the law of another Member State or a branch situated in another Member State.

3. Companies and firms within the meaning of the second paragraph of Article 48 of the Treaty and other legal bodies governed by public or private law, formed under the law of a Member State, with registered offices and head offices within the Community may form a subsidiary SE by subscribing for its shares, provided that each of at least two of them:

(a) is governed by the law of a different Member State, or

(b) has for at least two years had a subsidiary company governed by the law of another Member State or a branch situated in another Member State.

4. A public limited-liability company, formed under the law of a Member State, which has its registered office and head office within the Community may be transformed into an SE if for at least two years it has had a subsidiary company governed by the law of another Member State.

5. A Member State may provide that a company the head office of which is not in the Community may participate in the formation of an SE provided that company is formed under the law of a Member State, has its registered office in that Member State and has a real and continuous link with a Member State's economy.

Article 3

1. For the purposes of Article 2(1), (2) and (3), an SE shall be regarded as a public limited-liability company governed by the law of the Member State in which it has its registered office.

2. An SE may itself set up one or more subsidiaries in the form of SEs. The provisions of the law of the Member State in which a subsidiary SE has its registered office that require a public limited-liability company to have more than one shareholder shall not apply in the case of the subsidiary SE. The provisions of national law implementing the twelfth Council Company Law Directive (89/667/EEC) of 21 December 1989 on single-member private limited-liability companies [1] shall apply to SEs *mutatis mutandis*.

Article 4

1. The capital of an SE shall be expressed in euro.

2. The subscribed capital shall not be less than EUR 120 000.

3. The laws of a Member State requiring a greater subscribed capital for companies carrying on certain types of activity shall apply to SEs with registered offices in that Member State.

Article 5

Subject to Article 4(1) and (2), the capital of an SE, its maintenance and changes thereto, together with its shares, bonds and other similar securities shall be governed by the provisions which would apply to a public limited-liability company with a registered office in the Member State in which the SE is registered.

Article 6

For the purposes of this Regulation, 'the statutes of the SE' shall mean both the instrument of incorporation and, where they are the subject of a separate document, the statutes of the SE.

Article 7

The registered office of an SE shall be located within the Community, in the same Member State as its head office. A Member State may in addition impose on SEs registered in its territory the obligation of locating their head office and their registered office in the same place.

Article 8

1. The registered office of an SE may be transferred to another Member State in accordance with paragraphs 2 to 13. Such a transfer shall not result in the winding up of the SE or in the creation of a new legal person.

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[1] OJ L 395, 30.12.1989, p. 40. Directive as last amended by the 1994 Act of Accession.

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2. The management or administrative organ shall draw up a transfer proposal and publicise it in accordance with Article 13, without prejudice to any additional forms of publication provided for by the Member State of the registered office. That proposal shall state the current name, registered office and number of the SE and shall cover:

(a) the proposed registered office of the SE;

(b) the proposed statutes of the SE including, where appropriate, its new name;

(c) any implication the transfer may have on employees' involvement;

(d) the proposed transfer timetable;

(e) any rights provided for the protection of shareholders and/or creditors.

3. The management or administrative organ shall draw up a report explaining and justifying the legal and economic aspects of the transfer and explaining the implications of the transfer for shareholders, creditors and employees.

4. An SE's shareholders and creditors shall be entitled, at least one month before the general meeting called upon to decide on the transfer, to examine at the SE's registered office the transfer proposal and the report drawn up pursuant to paragraph 3 and, on request, to obtain copies of those documents free of charge.

5. A Member State may, in the case of SEs registered within its territory, adopt provisions designed to ensure appropriate protection for minority shareholders who oppose a transfer.

6. No decision to transfer may be taken for two months after publication of the proposal. Such a decision shall be taken as laid down in Article 59.

7. Before the competent authority issues the certificate mentioned in paragraph 8, the SE shall satisfy it that, in respect of any liabilities arising prior to the publication of the transfer proposal, the interests of creditors and holders of other rights in respect of the SE (including those of public bodies) have been adequately protected in accordance with requirements laid down by the Member State where the SE has its registered office prior to the transfer.

A Member State may extend the application of the first subparagraph to liabilities that arise (or may arise) prior to the transfer.

The first and second subparagraphs shall be without prejudice to the application to SEs of the national legislation of Member States concerning the satisfaction or securing of payments to public bodies.

8. In the Member State in which an SE has its registered office the court, notary or other competent authority shall issue a certificate attesting to the completion of the acts and formalities to be accomplished before the transfer.

9. The new registration may not be effected until the certificate referred to in paragraph 8 has been submitted, and evidence produced that the formalities required for registration in the country of the new registered office have been completed.

10. The transfer of an SE's registered office and the consequent amendment of its statutes shall take effect on the date on which the SE is registered, in accordance with Article 12, in the register for its new registered office.

11. When the SE's new registration has been effected, the registry for its new registration shall notify the registry for its old registration. Deletion of the old registration shall be effected on receipt of that notification, but not before.

12. The new registration and the deletion of the old registration shall be publicised in the Member States concerned in accordance with Article 13.

13. On publication of an SE's new registration, the new registered office may be relied on as against third parties. However, as long as the deletion of the SE's registration from the register for its previous registered office has not been publicised, third parties may continue to rely on the previous registered office unless the SE proves that such third parties were aware of the new registered office.

14. The laws of a Member State may provide that, as regards SEs registered in that Member State, the transfer of a registered office which would result in a change of the law applicable shall not take effect if any of that Member State's competent authorities opposes it within the two-month period referred to in paragraph 6. Such opposition may be based only on grounds of public interest.

Where an SE is supervised by a national financial supervisory authority according to Community directives the right to oppose the change of registered office applies to this authority as well.

Review by a judicial authority shall be possible.

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15. An SE may not transfer its registered office if proceedings for winding up, liquidation, insolvency or suspension of payments or other similar proceedings have been brought against it.

16. An SE which has transferred its registered office to another Member State shall be considered, in respect of any cause of action arising prior to the transfer as determined in paragraph 10, as having its registered office in the Member States where the SE was registered prior to the transfer, even if the SE is sued after the transfer.

Article 9

1. An SE shall be governed:

(a) by this Regulation,

(b) where expressly authorised by this Regulation, by the provisions of its statutes

or

(c) in the case of matters not regulated by this Regulation or, where matters are partly regulated by it, of those aspects not covered by it, by:

(i) the provisions of laws adopted by Member States in implementation of Community measures relating specifically to SEs;

(ii) the provisions of Member States' laws which would apply to a public limited-liability company formed in accordance with the law of the Member State in which the SE has its registered office;

(iii) the provisions of its statutes, in the same way as for a public limited-liability company formed in accordance with the law of the Member State in which the SE has its registered office.

2. The provisions of laws adopted by Member States specifically for the SE must be in accordance with Directives applicable to public limited-liability companies referred to in Annex I.

3. If the nature of the business carried out by an SE is regulated by specific provisions of national laws, those laws shall apply in full to the SE.

Article 10

Subject to this Regulation, an SE shall be treated in every Member State as if it were a public limited-liability company formed in accordance with the law of the Member State in which it has its registered office.

Article 11

1. The name of an SE shall be preceded or followed by the abbreviation SE.

2. Only SEs may include the abbreviation SE in their name.

3. Nevertheless, companies, firms and other legal entities registered in a Member State before the date of entry into force of this Regulation in the names of which the abbreviation SE appears shall not be required to alter their names.

Article 12

1. Every SE shall be registered in the Member State in which it has its registered office in a register designated by the law of that Member State in accordance with Article 3 of the first Council Directive (68/151/EEC) of 9 March 1968 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community [1].

2. An SE may not be registered unless an agreement on arrangements for employee involvement pursuant to Article 4 of Directive 2001/86/EC has been concluded, or a decision pursuant to Article 3(6) of the Directive has been taken, or the period for negotiations pursuant to Article 5 of the Directive has expired without an agreement having been concluded.

3. In order for an SE to be registered in a Member State which has made use of the option referred to in Article 7(3) of Directive 2001/86/EC, either an agreement pursuant to Article 4 of the Directive must have been concluded on the arrangements for employee involvement, including participation, or none of the participating companies must have been governed by participation rules prior to the registration of the SE.

4. The statutes of the SE must not conflict at any time with the arrangements for employee involvement which have been so determined. Where new such arrangements determined pursuant to the Directive conflict with the existing statutes, the statutes shall to the extent necessary be amended.

In this case, a Member State may provide that the management organ or the administrative organ of the SE shall be entitled to proceed to amend the statutes without any further decision from the general shareholders meeting.

[1] OJ L 65, 14.3.1968, p. 8. Directive as last amended by the 1994 Act of Accession.

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Article 13

Publication of the documents and particulars concerning an SE which must be publicised under this Regulation shall be effected in the manner laid down in the laws of the Member State in which the SE has its registered office in accordance with Directive 68/151/EEC.

Article 14

1. Notice of an SE's registration and of the deletion of such a registration shall be published for information purposes in the *Official Journal of the European Communities* after publication in accordance with Article 13. That notice shall state the name, number, date and place of registration of the SE, the date and place of publication and the title of publication, the registered office of the SE and its sector of activity.

2. Where the registered office of an SE is transferred in accordance with Article 8, notice shall be published giving the information provided for in paragraph 1, together with that relating to the new registration.

3. The particulars referred to in paragraph 1 shall be forwarded to the Office for Official Publications of the European Communities within one month of the publication referred to in Article 13.

TITLE II

FORMATION

Section 1

General

Article 15

1. Subject to this Regulation, the formation of an SE shall be governed by the law applicable to public limited-liability companies in the Member State in which the SE establishes its registered office.

2. The registration of an SE shall be publicised in accordance with Article 13.

Article 16

1. An SE shall acquire legal personality on the date on which it is registered in the register referred to in Article 12.

2. If acts have been performed in an SE's name before its registration in accordance with Article 12 and the SE does not assume the obligations arising out of such acts after its registration, the natural persons, companies, firms or other legal entities which performed those acts shall be jointly and severally liable therefor, without limit, in the absence of agreement to the contrary.

Section 2

Formation by merger

Article 17

1. An SE may be formed by means of a merger in accordance with Article 2(1).

2. Such a merger may be carried out in accordance with:

(a) the procedure for merger by acquisition laid down in Article 3(1) of the third Council Directive (78/855/EEC) of 9 October 1978 based on Article 54(3)(g) of the Treaty concerning mergers of public limited-liability companies [1] or

(b) the procedure for merger by the formation of a new company laid down in Article 4(1) of the said Directive.

In the case of a merger by acquisition, the acquiring company shall take the form of an SE when the merger takes place. In the case of a merger by the formation of a new company, the SE shall be the newly formed company.

Article 18

For matters not covered by this section or, where a matter is partly covered by it, for aspects not covered by it, each company involved in the formation of an SE by merger shall be governed by the provisions of the law of the Member State to which it is subject that apply to mergers of public limited-liability companies in accordance with Directive 78/855/EEC.

Article 19

The laws of a Member State may provide that a company governed by the law of that Member State may not take part in the formation of an SE by merger if any of that Member State's competent authorities opposes it before the issue of the certificate referred to in Article 25(2).

(1) OJ L 295, 20.10.1978, p. 36. Directive as last amended by the 1994 Act of Accession.

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Such opposition may be based only on grounds of public interest. Review by a judicial authority shall be possible.

Article 20

1. The management or administrative organs of merging companies shall draw up draft terms of merger. The draft terms of merger shall include the following particulars:

(a) the name and registered office of each of the merging companies together with those proposed for the SE;

(b) the share-exchange ratio and the amount of any compensation;

(c) the terms for the allotment of shares in the SE;

(d) the date from which the holding of shares in the SE will entitle the holders to share in profits and any special conditions affecting that entitlement;

(e) the date from which the transactions of the merging companies will be treated for accounting purposes as being those of the SE;

(f) the rights conferred by the SE on the holders of shares to which special rights are attached and on the holders of securities other than shares, or the measures proposed concerning them;

(g) any special advantage granted to the experts who examine the draft terms of merger or to members of the administrative, management, supervisory or controlling organs of the merging companies;

(h) the statutes of the SE;

(i) information on the procedures by which arrangements for employee involvement are determined pursuant to Directive 2001/86/EC.

2. The merging companies may include further items in the draft terms of merger.

Article 21

For each of the merging companies and subject to the additional requirements imposed by the Member State to which the company concerned is subject, the following particulars shall be published in the national gazette of that Member State:

(a) the type, name and registered office of every merging company;

(b) the register in which the documents referred to in Article 3(2) of Directive 68/151/EEC are filed in respect of each merging company, and the number of the entry in that register;

(c) an indication of the arrangements made in accordance with Article 24 for the exercise of the rights of the creditors of the company in question and the address at which complete information on those arrangements may be obtained free of charge;

(d) an indication of the arrangements made in accordance with Article 24 for the exercise of the rights of minority shareholders of the company in question and the address at which complete information on those arrangements may be obtained free of charge;

(e) the name and registered office proposed for the SE.

Article 22

As an alternative to experts operating on behalf of each of the merging companies, one or more independent experts as defined in Article 10 of Directive 78/855/EEC, appointed for those purposes at the joint request of the companies by a judicial or administrative authority in the Member State of one of the merging companies or of the proposed SE, may examine the draft terms of merger and draw up a single report to all the shareholders.

The experts shall have the right to request from each of the merging companies any information they consider necessary to enable them to complete their function.

Article 23

1. The general meeting of each of the merging companies shall approve the draft terms of merger.

2. Employee involvement in the SE shall be decided pursuant to Directive 2001/86/EC. The general meetings of each of the merging companies may reserve the right to make registration of the SE conditional upon its express ratification of the arrangements so decided.

Article 24

1. The law of the Member State governing each merging company shall apply as in the case of a merger of public limited-liability companies, taking into account the cross-border nature of the merger, with regard to the protection of the interests of:

(a) creditors of the merging companies;

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(b) holders of bonds of the merging companies;

(c) holders of securities, other than shares, which carry special rights in the merging companies.

2. A Member State may, in the case of the merging companies governed by its law, adopt provisions designed to ensure appropriate protection for minority shareholders who have opposed the merger.

Article 25

1. The legality of a merger shall be scrutinised, as regards the part of the procedure concerning each merging company, in accordance with the law on mergers of public limited-liability companies of the Member State to which the merging company is subject.

2. In each Member State concerned the court, notary or other competent authority shall issue a certificate conclusively attesting to the completion of the pre-merger acts and formalities.

3. If the law of a Member State to which a merging company is subject provides for a procedure to scrutinise and amend the share-exchange ratio, or a procedure to compensate minority shareholders, without preventing the registration of the merger, such procedures shall only apply if the other merging companies situated in Member States which do not provide for such procedure explicitly accept, when approving the draft terms of the merger in accordance with Article 23(1), the possibility for the shareholders of that merging company to have recourse to such procedure. In such cases, the court, notary or other competent authorities may issue the certificate referred to in paragraph 2 even if such a procedure has been commenced. The certificate must, however, indicate that the procedure is pending. The decision in the procedure shall be binding on the acquiring company and all its shareholders.

Article 26

1. The legality of a merger shall be scrutinised, as regards the part of the procedure concerning the completion of the merger and the formation of the SE, by the court, notary or other authority competent in the Member State of the proposed registered office of the SE to scrutinise that aspect of the legality of mergers of public limited-liability companies.

2. To that end each merging company shall submit to the competent authority the certificate referred to in Article 25(2) within six months of its issue together with a copy of the draft terms of merger approved by that company.

3. The authority referred to in paragraph 1 shall in particular ensure that the merging companies have approved draft terms of merger in the same terms and that arrangements for employee involvement have been determined pursuant to Directive 2001/86/EC.

4. That authority shall also satisfy itself that the SE has been formed in accordance with the requirements of the law of the Member State in which it has its registered office in accordance with Article 15.

Article 27

1. A merger and the simultaneous formation of an SE shall take effect on the date on which the SE is registered in accordance with Article 12.

2. The SE may not be registered until the formalities provided for in Articles 25 and 26 have been completed.

Article 28

For each of the merging companies the completion of the merger shall be publicised as laid down by the law of each Member State in accordance with Article 3 of Directive 68/151/EEC.

Article 29

1. A merger carried out as laid down in Article 17(2)(a) shall have the following consequences *ipso jure* and simultaneously:

(a) all the assets and liabilities of each company being acquired are transferred to the acquiring company;

(b) the shareholders of the company being acquired become shareholders of the acquiring company;

(c) the company being acquired ceases to exist;

(d) the acquiring company adopts the form of an SE.

2. A merger carried out as laid down in Article 17(2)(b) shall have the following consequences *ipso jure* and simultaneously:

(a) all the assets and liabilities of the merging companies are transferred to the SE;

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(b) the shareholders of the merging companies become shareholders of the SE;

(c) the merging companies cease to exist.

3. Where, in the case of a merger of public limited-liability companies, the law of a Member State requires the completion of any special formalities before the transfer of certain assets, rights and obligations by the merging companies becomes effective against third parties, those formalities shall apply and shall be carried out either by the merging companies or by the SE following its registration.

4. The rights and obligations of the participating companies on terms and conditions of employment arising from national law, practice and individual employment contracts or employment relationships and existing at the date of the registration shall, by reason of such registration be transferred to the SE upon its registration.

Article 30

A merger as provided for in Article 2(1) may not be declared null and void once the SE has been registered.

The absence of scrutiny of the legality of the merger pursuant to Articles 25 and 26 may be included among the grounds for the winding-up of the SE.

Article 31

1. Where a merger within the meaning of Article 17(2)(a) is carried out by a company which holds all the shares and other securities conferring the right to vote at general meetings of another company, neither Article 20(1)(b), (c) and (d), Article 29(1)(b) nor Article 22 shall apply. National law governing each merging company and mergers of public limited-liability companies in accordance with Article 24 of Directive 78/855/EEC shall nevertheless apply.

2. Where a merger by acquisition is carried out by a company which holds 90 % or more but not all of the shares and other securities conferring the right to vote at general meetings of another company, reports by the management or administrative body, reports by an independent expert or experts and the documents necessary for scrutiny shall be required only to the extent that the national law governing either the acquiring company or the company being acquired so requires.

Member States may, however, provide that this paragraph may apply where a company holds shares conferring 90 % or more but not all of the voting rights.

Section 3

Formation of a holding SE

Article 32

1. A holding SE may be formed in accordance with Article 2(2).

A company promoting the formation of a holding SE in accordance with Article 2(2) shall continue to exist.

2. The management or administrative organs of the companies which promote such an operation shall draw up, in the same terms, draft terms for the formation of the holding SE. The draft terms shall include a report explaining and justifying the legal and economic aspects of the formation and indicating the implications for the shareholders and for the employees of the adoption of the form of a holding SE. The draft terms shall also set out the particulars provided for in Article 20(1)(a), (b), (c), (f), (g), (h) and (i) and shall fix the minimum proportion of the shares in each of the companies promoting the operation which the shareholders must contribute to the formation of the holding SE. That proportion shall be shares conferring more than 50 % of the permanent voting rights.

3. For each of the companies promoting the operation, the draft terms for the formation of the holding SE shall be publicised in the manner laid down in each Member State's national law in accordance with Article 3 of Directive 68/151/EEC at least one month before the date of the general meeting called to decide thereon.

4. One or more experts independent of the companies promoting the operation, appointed or approved by a judicial or administrative authority in the Member State to which each company is subject in accordance with national provisions adopted in implementation of Directive 78/855/EEC, shall examine the draft terms of formation drawn up in accordance with paragraph 2 and draw up a written report for the shareholders of each company. By agreement between the companies promoting the operation, a single written report may be drawn up for the shareholders of all the companies by one or more independent experts, appointed or approved by a judicial or administrative authority in the Member State to which one of the companies promoting the operation or the proposed SE is subject in accordance with national provisions adopted in implementation of Directive 78/855/EEC.

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5. The report shall indicate any particular difficulties of valuation and state whether the proposed share-exchange ratio is fair and reasonable, indicating the methods used to arrive at it and whether such methods are adequate in the case in question.

6. The general meeting of each company promoting the operation shall approve the draft terms of formation of the holding SE.

Employee involvement in the holding SE shall be decided pursuant to Directive 2001/86/EC. The general meetings of each company promoting the operation may reserve the right to make registration of the holding SE conditional upon its express ratification of the arrangements so decided.

7. These provisions shall apply *mutatis mutandis* to private limited-liability companies.

Article 33

1. The shareholders of the companies promoting such an operation shall have a period of three months in which to inform the promoting companies whether they intend to contribute their shares to the formation of the holding SE. That period shall begin on the date upon which the terms for the formation of the holding SE have been finally determined in accordance with Article 32.

2. The holding SE shall be formed only if, within the period referred to in paragraph 1, the shareholders of the companies promoting the operation have assigned the minimum proportion of shares in each company in accordance with the draft terms of formation and if all the other conditions are fulfilled.

3. If the conditions for the formation of the holding SE are all fulfilled in accordance with paragraph 2, that fact shall, in respect of each of the promoting companies, be publicised in the manner laid down in the national law governing each of those companies adopted in implementation of Article 3 of Directive 68/151/EEC.

Shareholders of the companies promoting the operation who have not indicated whether they intend to make their shares available to the promoting companies for the purpose of forming the holding SE within the period referred to in paragraph 1 shall have a further month in which to do so.

4. Shareholders who have contributed their securities to the formation of the SE shall receive shares in the holding SE.

5. The holding SE may not be registered until it is shown that the formalities referred to in Article 32 have been completed and that the conditions referred to in paragraph 2 have been fulfilled.

Article 34

A Member State may, in the case of companies promoting such an operation, adopt provisions designed to ensure protection for minority shareholders who oppose the operation, creditors and employees.

Section 4

Formation of a subsidiary SE

Article 35

An SE may be formed in accordance with Article 2(3).

Article 36

Companies, firms and other legal entities participating in such an operation shall be subject to the provisions governing their participation in the formation of a subsidiary in the form of a public limited-liability company under national law.

Section 5

Conversion of an existing public limited-liability company into an SE

Article 37

1. An SE may be formed in accordance with Article 2(4).

2. Without prejudice to Article 12 the conversion of a public limited-liability company into an SE shall not result in the winding up of the company or in the creation of a new legal person.

3. The registered office may not be transferred from one Member State to another pursuant to Article 8 at the same time as the conversion is effected.

4. The management or administrative organ of the company in question shall draw up draft terms of conversion and a report explaining and justifying the legal and economic aspects of the conversion and indicating the implications for the shareholders and for the employees of the adoption of the form of an SE.

5. The draft terms of conversion shall be publicised in the manner laid down in each Member State's law in accordance with Article 3 of Directive 68/151/EEC at least one month before the general meeting called upon to decide thereon.

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6. Before the general meeting referred to in paragraph 7 one or more independent experts appointed or approved, in accordance with the national provisions adopted in implementation of Article 10 of Directive 78/855/EEC, by a judicial or administrative authority in the Member State to which the company being converted into an SE is subject shall certify in compliance with Directive 77/91/EEC [1] *mutatis mutandis* that the company has net assets at least equivalent to its capital plus those reserves which must not be distributed under the law or the Statutes.

7. The general meeting of the company in question shall approve the draft terms of conversion together with the statutes of the SE. The decision of the general meeting shall be passed as laid down in the provisions of national law adopted in implementation of Article 7 of Directive 78/855/EEC.

8. Member States may condition a conversion to a favourable vote of a qualified majority or unanimity in the organ of the company to be converted within which employee participation is organised.

9. The rights and obligations of the company to be converted on terms and conditions of employment arising from national law, practice and individual employment contracts or employment relationships and existing at the date of the registration shall, by reason of such registration be transferred to the SE.

TITLE III

STRUCTURE OF THE SE

Article 38

Under the conditions laid down by this Regulation an SE shall comprise:

(a) a general meeting of shareholders and

(b) either a supervisory organ and a management organ (two-tier system) or an administrative organ (one-tier system) depending on the form adopted in the statutes.

(1) Second Council Directive 77/91/EEC of 13 December 1976 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of Article 58 of the Treaty, in respect of the formation of public limited liability companies and the maintenance and alteration of their capital, with a view to making such safeguards equivalent (OJ L 26, 31.1.1977, p. 1). Directive as last amended by the 1994 Act of Accession.

Section 1

Two-tier system

Article 39

1. The management organ shall be responsible for managing the SE. A Member State may provide that a managing director or managing directors shall be responsible for the current management under the same conditions as for public limited-liability companies that have registered offices within that Member State's territory.

2. The member or members of the management organ shall be appointed and removed by the supervisory organ.

A Member State may, however, require or permit the statutes to provide that the member or members of the management organ shall be appointed and removed by the general meeting under the same conditions as for public limited-liability companies that have registered offices within its territory.

3. No person may at the same time be a member of both the management organ and the supervisory organ of the same SE. The supervisory organ may, however, nominate one of its members to act as a member of the management organ in the event of a vacancy. During such a period the functions of the person concerned as a member of the supervisory organ shall be suspended. A Member State may impose a time limit on such a period.

4. The number of members of the management organ or the rules for determining it shall be laid down in the SE's statutes. A Member State may, however, fix a minimum and/or a maximum number.

5. Where no provision is made for a two-tier system in relation to public limited-liability companies with registered offices within its territory, a Member State may adopt the appropriate measures in relation to SEs.

Article 40

1. The supervisory organ shall supervise the work of the management organ. It may not itself exercise the power to manage the SE.

2. The members of the supervisory organ shall be appointed by the general meeting. The members of the first supervisory organ may, however, be appointed by the statutes. This shall apply without prejudice to Article 47(4) or to any employee participation arrangements determined pursuant to Directive 2001/86/EC.

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3. The number of members of the supervisory organ or the rules for determining it shall be laid down in the statutes. A Member State may, however, stipulate the number of members of the supervisory organ for SEs registered within its territory or a minimum and/or a maximum number.

Article 41

1. The management organ shall report to the supervisory organ at least once every three months on the progress and foreseeable development of the SE's business.

2. In addition to the regular information referred to in paragraph 1, the management organ shall promptly pass the supervisory organ any information on events likely to have an appreciable effect on the SE.

3. The supervisory organ may require the management organ to provide information of any kind which it needs to exercise supervision in accordance with Article 40(1). A Member State may provide that each member of the supervisory organ also be entitled to this facility.

4. The supervisory organ may undertake or arrange for any investigations necessary for the performance of its duties.

5. Each member of the supervisory organ shall be entitled to examine all information submitted to it.

Article 42

The supervisory organ shall elect a chairman from among its members. If half of the members are appointed by employees, only a member appointed by the general meeting of shareholders may be elected chairman.

Section 2

The one-tier system

Article 43

1. The administrative organ shall manage the SE. A Member State may provide that a managing director or managing directors shall be responsible for the day-to-day management under the same conditions as for public limited-liability companies that have registered offices within that Member State's territory.

2. The number of members of the administrative organ or the rules for determining it shall be laid down in the SE's statutes. A Member State may, however, set a minimum and, where necessary, a maximum number of members.

The administrative organ shall, however, consist of at least three members where employee participation is regulated in accordance with Directive 2001/86/EC.

3. The member or members of the administrative organ shall be appointed by the general meeting. The members of the first administrative organ may, however, be appointed by the statutes. This shall apply without prejudice to Article 47(4) or to any employee participation arrangements determined pursuant to Directive 2001/86/EC.

4. Where no provision is made for a one-tier system in relation to public limited-liability companies with registered offices within its territory, a Member State may adopt the appropriate measures in relation to SEs.

Article 44

1. The administrative organ shall meet at least once every three months at intervals laid down by the statutes to discuss the progress and foreseeable development of the SE's business.

2. Each member of the administrative organ shall be entitled to examine all information submitted to it.

Article 45

The administrative organ shall elect a chairman from among its members. If half of the members are appointed by employees, only a member appointed by the general meeting of shareholders may be elected chairman.

Section 3

Rules common to the one-tier and two-tier systems

Article 46

1. Members of company organs shall be appointed for a period laid down in the statutes not exceeding six years.

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2. Subject to any restrictions laid down in the statutes, members may be reappointed once or more than once for the period determined in accordance with paragraph 1.

Article 47

1. An SE's statutes may permit a company or other legal entity to be a member of one of its organs, provided that the law applicable to public limited-liability companies in the Member State in which the SE's registered office is situated does not provide otherwise.

That company or other legal entity shall designate a natural person to exercise its functions on the organ in question.

2. No person may be a member of any SE organ or a representative of a member within the meaning of paragraph 1 who:

(a) is disqualified, under the law of the Member State in which the SE's registered office is situated, from serving on the corresponding organ of a public limited-liability company governed by the law of that Member State, or

(b) is disqualified from serving on the corresponding organ of a public limited-liability company governed by the law of a Member State owing to a judicial or administrative decision delivered in a Member State.

3. An SE's statutes may, in accordance with the law applicable to public limited-liability companies in the Member State in which the SE's registered office is situated, lay down special conditions of eligibility for members representing the shareholders.

4. This Regulation shall not affect national law permitting a minority of shareholders or other persons or authorities to appoint some of the members of a company organ.

Article 48

1. An SE's statutes shall list the categories of transactions which require authorisation of the management organ by the supervisory organ in the two-tier system or an express decision by the administrative organ in the one-tier system.

A Member State may, however, provide that in the two-tier system the supervisory organ may itself make certain categories of transactions subject to authorisation.

2. A Member State may determine the categories of transactions which must at least be indicated in the statutes of SEs registered within its territory.

Article 49

The members of an SE's organs shall be under a duty, even after they have ceased to hold office, not to divulge any information which they have concerning the SE the disclosure of which might be prejudicial to the company's interests, except where such disclosure is required or permitted under national law provisions applicable to public limited-liability companies or is in the public interest.

Article 50

1. Unless otherwise provided by this Regulation or the statutes, the internal rules relating to quorums and decision-taking in SE organs shall be as follows:

(a) quorum: at least half of the members must be present or represented;

(b) decision-taking: a majority of the members present or represented.

2. Where there is no relevant provision in the statutes, the chairman of each organ shall have a casting vote in the event of a tie. There shall be no provision to the contrary in the statutes, however, where half of the supervisory organ consists of employees' representatives.

3. Where employee participation is provided for in accordance with Directive 2001/86/EC, a Member State may provide that the supervisory organ's quorum and decision-making shall, by way of derogation from the provisions referred to in paragraphs 1 and 2, be subject to the rules applicable, under the same conditions, to public limited-liability companies governed by the law of the Member State concerned.

Article 51

Members of an SE's management, supervisory and administrative organs shall be liable, in accordance with the provisions applicable to public limited-liability companies in the Member State in which the SE's registered office is situated, for loss or damage sustained by the SE following any breach on their part of the legal, statutory or other obligations inherent in their duties.

Section 4

General meeting

Article 52

The general meeting shall decide on matters for which it is given sole responsibility by:

(a) this Regulation or

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(b) the legislation of the Member State in which the SE's registered office is situated adopted in implementation of Directive 2001/86/EC.

Furthermore, the general meeting shall decide on matters for which responsibility is given to the general meeting of a public limited-liability company governed by the law of the Member State in which the SE's registered office is situated, either by the law of that Member State or by the SE's statutes in accordance with that law.

Article 53

Without prejudice to the rules laid down in this section, the organisation and conduct of general meetings together with voting procedures shall be governed by the law applicable to public limited-liability companies in the Member State in which the SE's registered office is situated.

Article 54

1. An SE shall hold a general meeting at least once each calendar year, within six months of the end of its financial year, unless the law of the Member State in which the SE's registered office is situated applicable to public limited-liability companies carrying on the same type of activity as the SE provides for more frequent meetings. A Member State may, however, provide that the first general meeting may be held at any time in the 18 months following an SE's incorporation.

2. General meetings may be convened at any time by the management organ, the administrative organ, the supervisory organ or any other organ or competent authority in accordance with the national law applicable to public limited-liability companies in the Member State in which the SE's registered office is situated.

Article 55

1. One or more shareholders who together hold at least 10 % of an SE's subscribed capital may request the SE to convene a general meeting and draw up the agenda therefor; the SE's statutes or national legislation may provide for a smaller proportion under the same conditions as those applicable to public limited-liability companies.

2. The request that a general meeting be convened shall state the items to be put on the agenda.

3. If, following a request made under paragraph 1, a general meeting is not held in due time and, in any event, within two months, the competent judicial or administrative authority within the jurisdiction of which the SE's registered office is situated may order that a general meeting be convened within a given period or authorise either the shareholders who have requested it or their representatives to convene a general meeting. This shall be without prejudice to any national provisions which allow the shareholders themselves to convene general meetings.

Article 56

One or more shareholders who together hold at least 10 % of an SE's subscribed capital may request that one or more additional items be put on the agenda of any general meeting. The procedures and time limits applicable to such requests shall be laid down by the national law of the Member State in which the SE's registered office is situated or, failing that, by the SE's statutes. The above proportion may be reduced by the statutes or by the law of the Member State in which the SE's registered office is situated under the same conditions as are applicable to public limited-liability companies.

Article 57

Save where this Regulation or, failing that, the law applicable to public limited-liability companies in the Member State in which an SE's registered office is situated requires a larger majority, the general meeting's decisions shall be taken by a majority of the votes validly cast.

Article 58

The votes cast shall not include votes attaching to shares in respect of which the shareholder has not taken part in the vote or has abstained or has returned a blank or spoilt ballot paper.

Article 59

1. Amendment of an SE's statutes shall require a decision by the general meeting taken by a majority which may not be less than two thirds of the votes cast, unless the law applicable to public limited-liability companies in the Member State in which an SE's registered office is situated requires or permits a larger majority.

2. A Member State may, however, provide that where at least half of an SE's subscribed capital is represented, a simple majority of the votes referred to in paragraph 1 shall suffice.

3. Amendments to an SE's statutes shall be publicised in accordance with Article 13.

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Article 60

1. Where an SE has two or more classes of shares, every decision by the general meeting shall be subject to a separate vote by each class of shareholders whose class rights are affected thereby.

2. Where a decision by the general meeting requires the majority of votes specified in Article 59(1) or (2), that majority shall also be required for the separate vote by each class of shareholders whose class rights are affected by the decision.

TITLE IV

ANNUAL ACCOUNTS AND CONSOLIDATED ACCOUNTS

Article 61

Subject to Article 62 an SE shall be governed by the rules applicable to public limited-liability companies under the law of the Member State in which its registered office is situated as regards the preparation of its annual and, where appropriate, consolidated accounts including the accompanying annual report and the auditing and publication of those accounts.

Article 62

1. An SE which is a credit or financial institution shall be governed by the rules laid down in the national law of the Member State in which its registered office is situated in implementation of Directive 2000/12/EC 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 (1) as regards the preparation of its annual and, where appropriate, consolidated accounts, including the accompanying annual report and the auditing and publication of those accounts.

2. An SE which is an insurance undertaking shall be governed by the rules laid down in the national law of the Member State in which its registered office is situated in implementation of Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings (2) as regards the preparation of its annual and, where appropriate, consolidated accounts including the accompanying annual report and the auditing and publication of those accounts.

(1) OJ L 126, 26.5.2000, p. 1.
(2) OJ L 374, 31.12.1991, p. 7.

TITLE V

WINDING UP, LIQUIDATION, INSOLVENCY AND CESSATION OF PAYMENTS

Article 63

As regards winding up, liquidation, insolvency, cessation of payments and similar procedures, an SE shall be governed by the legal provisions which would apply to a public limited-liability company formed in accordance with the law of the Member State in which its registered office is situated, including provisions relating to decision-making by the general meeting.

Article 64

1. When an SE no longer complies with the requirement laid down in Article 7, the Member State in which the SE's registered office is situated shall take appropriate measures to oblige the SE to regularise its position within a specified period either:

(a) by re-establishing its head office in the Member State in which its registered office is situated or

(b) by transferring the registered office by means of the procedure laid down in Article 8.

2. The Member State in which the SE's registered office is situated shall put in place the measures necessary to ensure that an SE which fails to regularise its position in accordance with paragraph 1 is liquidated.

3. The Member State in which the SE's registered office is situated shall set up a judicial remedy with regard to any established infringement of Article 7. That remedy shall have a suspensory effect on the procedures laid down in paragraphs 1 and 2.

4. Where it is established on the initiative of either the authorities or any interested party that an SE has its head office within the territory of a Member State in breach of Article 7, the authorities of that Member State shall immediately inform the Member State in which the SE's registered office is situated.

Article 65

Without prejudice to provisions of national law requiring additional publication, the initiation and termination of winding up, liquidation, insolvency or cessation of payment procedures and any decision to continue operating shall be publicised in accordance with Article 13.

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Article 66

1. An SE may be converted into a public limited-liability company governed by the law of the Member State in which its registered office is situated. No decision on conversion may be taken before two years have elapsed since its registration or before the first two sets of annual accounts have been approved.

2. The conversion of an SE into a public limited-liability company shall not result in the winding up of the company or in the creation of a new legal person.

3. The management or administrative organ of the SE shall draw up draft terms of conversion and a report explaining and justifying the legal and economic aspects of the conversion and indicating the implications of the adoption of the public limited-liability company for the shareholders and for the employees.

4. The draft terms of conversion shall be publicised in the manner laid down in each Member State's law in accordance with Article 3 of Directive 68/151/EEC at least one month before the general meeting called to decide thereon.

5. Before the general meeting referred to in paragraph 6, one or more independent experts appointed or approved, in accordance with the national provisions adopted in implementation of Article 10 of Directive 78/855/EEC, by a judicial or administrative authority in the Member State to which the SE being converted into a public limited-liability company is subject shall certify that the company has assets at least equivalent to its capital.

6. The general meeting of the SE shall approve the draft terms of conversion together with the statutes of the public limited-liability company. The decision of the general meeting shall be passed as laid down in the provisions of national law adopted in implementation of Article 7 of Directive 78/855/EEC.

TITLE VI

ADDITIONAL AND TRANSITIONAL PROVISIONS

Article 67

1. If and so long as the third phase of economic and monetary union (EMU) does not apply to it each Member State may make SEs with registered offices within its territory subject to the same provisions as apply to public limited-liability companies covered by its legislation as regards the expression of their capital. An SE may, in any case, express its capital in euro as well. In that event the national currency/euro conversion rate shall be that for the last day of the month preceding that of the formation of the SE.

2. If and so long as the third phase of EMU does not apply to the Member State in which an SE has its registered office, the SE may, however, prepare and publish its annual and, where appropriate, consolidated accounts in euro. The Member State may require that the SE's annual and, where appropriate, consolidated accounts be prepared and published in the national currency under the same conditions as those laid down for public limited-liability companies governed by the law of that Member State. This shall not prejudge the additional possibility for an SE of publishing its annual and, where appropriate, consolidated accounts in euro in accordance with Council Directive 90/604/EEC of 8 November 1990 amending Directive 78/60/EEC on annual accounts and Directive 83/349/EEC on consolidated accounts as concerns the exemptions for small and medium-sized companies and the publication of accounts in ecu [1].

TITLE VII

FINAL PROVISIONS

Article 68

1. The Member States shall make such provision as is appropriate to ensure the effective application of this Regulation.

2. Each Member State shall designate the competent authorities within the meaning of Articles 8, 25, 26, 54, 55 and 64. It shall inform the Commission and the other Member States accordingly.

Article 69

Five years at the latest after the entry into force of this Regulation, the Commission shall forward to the Council and the European Parliament a report on the application of the Regulation and proposals for amendments, where appropriate. The report shall, in particular, analyse the appropriateness of:

(a) allowing the location of an SE's head office and registered office in different Member States;

(b) broadening the concept of merger in Article 17(2) in order to admit also other types of merger than those defined in Articles 3(1) and 4(1) of Directive 78/855/EEC;

[1] OJ L 317, 16.11.1990, p. 57.

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(c) revising the jurisdiction clause in Article 8(16) in the light of any provision which may have been inserted in the 1968 Brussels Convention or in any text adopted by Member States or by the Council to replace such Convention;

(d) allowing provisions in the statutes of an SE adopted by a Member State in execution of authorisations given to the Member States by this Regulation or laws adopted to ensure the effective application of this Regulation in respect to the SE which deviate from or are complementary to these laws, even when such provisions would not be authorised in the statutes of a public limited-liability company having its registered office in the Member State.

Article 70

This Regulation shall enter into force on 8 October 2004.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Luxembourg, 8 October 2001.

For the Council

The President

L. ONKELINX

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ANNEX I

PUBLIC LIMITED-LIABILITY COMPANIES REFERRED TO IN ARTICLE 2(1)

BELGIUM:

la société anonyme/de naamloze vennootschap

DENMARK:

aktieselskaber

GERMANY:

die Aktiengesellschaft

GREECE:

ανώνυμη εταιρία

SPAIN:

la sociedad anónima

FRANCE:

la société anonyme

IRELAND:

public companies limited by shares

public companies limited by guarantee having a share capital

ITALY:

società per azioni

LUXEMBOURG:

la société anonyme

NETHERLANDS:

de naamloze vennootschap

AUSTRIA:

die Aktiengesellschaft

PORTUGAL:

a sociedade anónima de responsabilidade limitada

FINLAND:

julkinen osakeyhtiö/publikt aktiebolag

SWEDEN:

publikt aktiebolag

UNITED KINGDOM:

public companies limited by shares

public companies limited by guarantee having a share capital

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ANNEX II

PUBLIC AND PRIVATE LIMITED-LIABILITY COMPANIES REFERRED TO IN ARTICLE 2(2)

BELGIUM:

la société anonyme/de naamloze vennootschap,

la société privée à responsabilité limitée/besloten vennootschap met beperkte aansprakelijkheid

DENMARK:

aktieselskaber,

anpartselskaber

GERMANY:

die Aktiengesellschaft,

die Gesellschaft mit beschränkter Haftung

GREECE:

ανώνυμη εταιρία

εταιρία περιορισμένης ευθύνης

SPAIN:

la sociedad anónima,

la sociedad de responsabilidad limitada

FRANCE:

la société anonyme,

la société à responsabilité limitée

IRELAND:

public companies limited by shares,

public companies limited by guarantee having a share capital,

private companies limited by shares,

private companies limited by guarantee having a share capital

ITALY:

società per azioni,

società a responsabilità limitata

LUXEMBOURG:

la société anonyme,

la société à responsabilité limitée

NETHERLANDS:

de naamloze vennootschap,

de besloten vennootschap met beperkte aansprakelijkheid

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AUSTRIA:

die Aktiengesellschaft,

die Gesellschaft mit beschränkter Haftung

PORTUGAL:

a sociedade anónima de responsabilidade limitada,

a sociedade por quotas de responsabilidade limitada

FINLAND:

osakeyhtiö

aktiebolag

SWEDEN:

aktiebolag

UNITED KINGDOM:

public companies limited by shares,

public companies limited by guarantee having a share capital,

private companies limited by shares,

private companies limited by guarantee having a share capital

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