

Corporate governance framework for European companies: what needs to be improved?

One of the lessons of the financial crisis is that corporate governance, until now usually based on self-regulation, was not as effective as it could have been. It is important that companies are better run. If companies are better run, not only is a future crisis less likely but they should also be more competitive. The European Commission has launched today a public consultation that addresses the ways in which corporate governance of European companies can be improved. Corporate governance is traditionally defined as the system by which companies are managed and controlled. The consultation covers a number of issues such as how to improve the diversity and functioning of the boards of directors and the monitoring and enforcement of existing national corporate governance codes, and how to enhance the engagement of shareholders. The deadline for submitting contributions in response to the consultation is 22 July 2011.

Internal Market and Services Commissioner Michel Barnier said: *"In the current economic situation, we need more than ever to ensure that companies are well governed and consequently reliable and sustainable. Too much short term thinking has had disastrous consequences. That is why we have launched today a debate on the effectiveness of the existing corporate governance framework. Above all, we need company boards to be more effective and shareholders to fully assume their responsibilities."*

What does the public consultation cover?

The lessons of the crisis will eventually lead to better supervision of financial institutions, stronger banks and effective resolution systems for failing institutions. As part of a longer term review of the corporate governance framework of companies at large, this public consultation will focus on how companies, not just financial institutions, work. There are a number of findings that indicate that there is room for improvement in different areas of corporate governance¹, such as diversity in boards, shareholder engagement and the quality of corporate governance statements.

¹ See e.g. the study on Monitoring and Enforcement Practices in Corporate Governance in the Member States, available at http://ec.europa.eu/internal_market/company/ecgforum/studies_en.htm, or Paul Woolley, 'Why are financial markets so inefficient and exploitative — and a suggested remedy', in *The Future of Finance: The LSE Report*, 2010, or the Statement by the European Corporate Governance Forum of 23 March 2009, or Heidrick & Struggles, *Corporate Governance Report 2009 — Boards in turbulent times*.

Thus, the Green Paper aims to launch a general debate on a number of issues such as:

- 1. **Board of directors**: questions addressed refer to their effective functioning and ensuring they are composed of a mixed group of people, e.g. by enhancing gender diversity, a variety of professional backgrounds and skills as well as nationalities. Functioning of boards, namely in terms of availability and time commitment of directors are also under scrutiny as well as questions on risk management and directors' pay..
- 2. how to enhance **shareholders' involvement** on corporate governance issues and encourage more of them to take an interest in sustainable returns and longer term performance, but also how to enhance the protection of minority shareholders. It also seeks to understand whether there is a need for shareholder identification, i.e. for a mechanism to allow issuers to see who their shareholders are, and for an improved framework for shareholder cooperation.
- 3. how to improve **monitoring and enforcement of the existing national corporate governance codes**² in order to provide investors and the public with meaningful information. Companies who don't comply with national corporate governance recommendations have to explain why they deviate from them. Too often, this doesn't occur. The Green Paper asks whether there should be more detailed rules on these explanations and whether national monitoring bodies should have more say on companies' corporate governance statements.

What are the next steps?

The consultation is open until 22 July 2011. The Commission will carefully examine all the replies to the consultation and issue a feedback statement summarising the results of the consultation in autumn. On this basis a decision will be made whether legislative proposals are necessary. They will, however, be tabled only after conducting a thorough impact assessment.

Background information:

Currently there exists at EU level a body of corporate governance principles and rules. It consists of a number of recommendations on the independence of non-executive directors, on board committees, and on remuneration. Moreover, it also contains the obligation for listed companies to issue a corporate governance statement. The directives on takeovers (Directive 2004/25/EC), transparency of listed companies (Directive 2004/109/EC), shareholders' rights (Directive 2007/36/EC), market abuse Directive (2003/6/EC) and audit Directive (2006/43/EC) shape the corporate governance landscape in the EU.

For more information see [MEMO/11/218](#)

http://ec.europa.eu/internal_market/company/modern/corporate-governance-framework_en.htm

The Green Paper is accessible at:

http://ec.europa.eu/internal_market/consultations/2011/corporate-governance-framework_en.htm

² A corporate governance code presents essential recommendations for the management and supervision of listed companies and contains standards for good and responsible governance. A very complete list of existing corporate governance codes can be found under: http://www.ecgi.org/codes/all_codes.php