ecoDa
a.s.b.l.

The European Voice of Directors

COMPLY OR EXPLAIN

PRESERVING GOVERNANCE FLEXIBILITY WITH QUALITY EXPLANATIONS

REPORT
ECODA ANNUAL CONFERENCE 2012

PREFACE

Throughout Europe, the governance of listed companies is reigned by governance codes that offer the companies a frame of reference based on best practices, which companies are supposed to comply with, or in the case of non-compliance those companies are (now) legally obliged to explain why they deviate from the code's recommendation. Consequently, comply-or-explain (CoE) in general and the quality of explanations more specifically is expected to be one of the top priorities of the European Action Plan on corporate governance.

The 2008 ISS/Risk Metrics study -to which ecoDa as a partner organization contributed actively- demonstrated that there was widespread support for this flexible approach but at the same time revealed that the quality of explanations deserved special attention. Although governance practices have improved considerably since then, the European Commission stated in its 2011 Governance Green Paper that the quality of the explanations still offers substantial room for improvement. Although the Commission so far has dealt with this issue with caution and pragmatism, some make a plea for abandoning all together the flexibility the governance codes offer.

Convinced that such a move would be detrimental to a substantive improvement of the governance practices and would even be unfeasible for the largest part of the more qualitative governance recommendations, ecoDa –the Voice of European Directors- took the initiative to organize a European Conference on this theme. ecoDa is convinced that only an improvement of the quality of explanations can safeguard the flexibility offered today by the European governance approach. ecoDa is very grateful to all who contributed to the success of this European Conference, especially to its speakers and moderators, listed in Appendix 1.

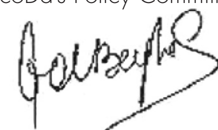
Notwithstanding the quality of the contributions presented at this conference and the interesting ideas expressed during the different panel discussions, ecoDa is of the opinion that only a printed report can further feed and hopefully enhance these European discussions. ecoDa is therefore very grateful to Mazars who, besides sponsoring the conference, also accepted to sponsor this publication. For more information on Mazars, see Appendix 2.

The Policy Committee of ecoDa and the ecoDa board (for more information see Appendix 3) have taken the opportunity of this report to further reflect on its position towards more qualitative explanations, and more generally towards a corporate governance that really fosters long-term economic development and prosperity. This report is therefore more than just a report on the 2012 conference, but also contains our strategic map for further improving the quality of corporate governance in Europe.

We wish you all an interesting read. We are open to all suggestions to improve our understanding and positioning on corporate governance (www.ecoda.org).

Patrick Zurstrassen
Chairman of ecoDa

Lutgart van den Berghe
ecoDa's Board Member and Chairwoman of ecoDa's Policy Committee



REPORT

The Comply-or-Explain approach

In all Member States, there is a legal obligation for listed companies to comply with Corporate Governance Codes and if they don't comply they have to explain the reasons for not complying with the provisions of the Code. **The Comply or Explain (CoE) principle is an obligation for listed companies** throughout Europe. This principle has been formally endorsed by the European Commission to be **applicable in all Member States by 2009**:

"The Comply or Explain (CoE) principle allows companies to adapt their corporate governance practices to their specific situation (taking into consideration their size, shareholding structure, and sectoral specificities). It is also thought to make companies more responsible by encouraging them to consider whether their corporate governance practices are appropriate and by giving them a target to meet"[1] .

The CoE principle has been copied from the UK Code which was perceived to be the best Code from the point of view of the investors' world.

By opting for CoE, **the Commission has explicitly made the choice for flexibility**. Flexibility was seen as the condition to guarantee that companies have their governance tailored to their specific needs. Indeed, companies are facing different challenges and they should be able to opt for a governance model that allows them to cope with these specific challenges. As an example, in countries where combining the board chair with the executive leadership is contrary to the Code's recommendation, the Code's flexibility enables a board chairman to (temporarily) become the executive chairman, for instance when the chief executive is forced to step down because irregularities are detected or due to a sudden accident.

The ISS report and the practical application of Comply-or-Explain

The study ordered by the European Commission back in 2008 and undertaken by ISS[2] showed that there is **broad support** for the self-regulatory route from business organisations, institutes of directors as well as investors. They all support combining flexibility with the obligation to explain any deviations from the provisions of the code. The study observed that most stakeholders viewed this approach as preferable to stricter legislation.

At the same time however, the study concluded that there was a **need to strengthen CoE**. There should be more attention paid to the **quality of explanations and** to the **monitoring** of those explanations.

1 The EU Green Paper on Corporate Governance Framework, April 2011
2 With the support of ecoDa, BusinessEurope and Landwell.

Notwithstanding the validity of this general conclusion, one should not forget that the study reflected on the situation in 2008. The EU Regulation on CoE had only been nationally embedded into law in 2009 (and was probably only in application in the different Member States some time after that).

The requisite for more corporate accountability

In 2011 the European Commission launched a debate on the future of CoE (and self-regulation) again through the EU Green Paper on the Corporate Framework. The European Commission expressed the view that:

"Some adjustments appear necessary to improve the application of the corporate governance codes. The solutions should not alter the fundamentals of the 'comply or explain' approach but contribute to its effective functioning by improving the informative quality of the reports."

According to the feedback statement, the EU consultation found that a **large majority of respondents supported the CoE principle while there was considerable opposition to its replacement with an increased emphasis on compulsory corporate governance rules**.

However, at the time of the launch of the Green Paper in April 2011, **few countries had taken concrete steps to improve the informative value of the explanations** by giving more concrete guidance or by defining what a good explanation meant. The EU Green Paper referred to the Swedish corporate governance code as a potential best practice benchmark. According to the EU, the Swedish approach includes an interesting requirement which provides that[3] :

"In its corporate governance report, the company is to state clearly which Code rules it has not complied with, explain the reasons for each case of non-compliance and describe the solution it has adopted instead".

The EU considers that:

"It would indeed seem appropriate to require that companies not only disclose the reasons for departure from a given recommendation, but also give a detailed description of the solution applied instead".

Regarding compliance with the code, it is **important to distinguish between formal compliance and substantive compliance**. Looking at formal compliance, most countries refer to an acceptance rate of over 90%. However such statistics don't provide a sufficient insight into the substance of implementing the recommendations. They are dealing with **formal aspects** of implementation and most of these issues don't really bring added value. It is **rather a boiler plate exercise**. Moreover the CoE approach is only applied to those parts of the codes that can be publicly observed. Regarding substantive implementation, the question of how far the statements correspond to reality remains open. Of course, it is **very difficult to provide a reliable public report or to externally monitor the substantive quality** of private conversations within the board. Here public transparency doesn't bring the solution; it is only with extensive (and independent)

3 Code Rule 10.1 of the Swedish Corporate Governance Code

board assessment that one can bridge the gap between formal compliance and substantive compliance.

But first and foremost, it is **important to instil a culture of accountability** within the listed companies. Flexibility offers a great opportunity to take the specific business context into consideration, but directors should demonstrate their compliance with the overarching principles of the Code. In other words, they are accountable for the use they make of the flexibility offered by the Code. Accountability is an obligation which corporate boards must respect. Otherwise CoE will no longer be a credible route nor be acceptable by society at large.

Legitimacy of CG Codes and of the flexible approach

There is a **substantial misunderstanding** in the public arena with respect to the compliance with corporate governance codes. It is commonly argued that compliance with a code is an **easy ride** for companies. In practice we observe that many companies wrestle a good deal with the requirements of codes. Moreover, many observers **see a deviation from a provision as a breach, an unacceptable violation**, whereas it can be a necessary condition for more effective governance, tailored to the needs and challenges a specific company is facing. Consequently, most listed companies strive for approaching 100% compliance, even if this is counterproductive for their specific governance and business situation. Formalism and ineffectiveness are the consequence.

The flexibility the governance codes offer should be seen as legitimate by the relevant stakeholders. However, in a European context, it is **difficult to compare the outcome of the compliance** with the codes. The CoE-approach was imported from the UK where there is a more dispersed shareholding with mostly outside shareholders, which are well organised as active monitors. The CoE principle based on flexibility and accountability seems to work in a system where accountability rules are embedded in the system's thinking and where shareholders and companies are not too far away from each other. While collaborating closely, shareholders remain outsiders. This experiment in the UK was exported to other Member States with completely different shareholding typologies, different (accountability) cultures and mechanisms of making law. Legal social cultures differ and such social cultures have a huge impact on how codes work in practice. There are also large differences in the legal status of CG Codes. Codes vary considerably in approach with quite different degrees of detail. Codes with detailed provisions should allow for more deviations (as they would not fit all companies) while codes with high level principles make it difficult to explain why you don't comply with the principle. High level principles or very detailed rules are not implemented in the same way. Both the UK and the Dutch Codes for instance include high level principles with a different level of detailed practices. The Dutch code specifies that the board has to certify that the internal control is effective but it does not define the process. In fact, boards should not expect the code to tell them how to do so. Moreover, there are substantial differences among the Member States in the type of 'Drafting commission' and 'Monitoring organisation'. In this respect, quite important differences exist as to the role played by the government,

the market authorities, the investors and the business world itself. For instance in the Netherlands, the Code was drafted and is monitored by a broad coalition of relevant stakeholders with an important role played by the relevant ministries. In France on the contrary, initiatives have purely been taken by the business federations (with two codes, respectively of AFEP-Medef and Middlenext) while the market supervisor, the AMF plays a role as monitoring organisation. However, the public authorities play an active role of influence not to say pressure and can take the initiative. For example, the Afep-Medef recommendation on executive remuneration was added to the Code under strong public pressure; the quota law was taken because of public authorities' belief that gender diversity, although included in the Code, was not going fast enough.

It is important that the Commission accepts that there is not one valid governance model throughout the EU. Europe offers an enormous diversity in governance practices, corporate forms and shareholding structures which call for a tailored approach. It is questioneable whether the route followed until now has sufficiently taken this diversity into consideration. In general, every aspect of corporate life cannot be harmonized. Codetermination can work well in Germany while it might be a disaster in the United Kingdom. People should return to the importance of subsidiarity, respecting the cultures and the different types of capitalism as well as the way businesses operate throughout Europe.

CoE offers the flexibility to fit with the large diversity among and within the different EU Member States. As such, CG Codes and the best practices they are built upon can become the toolkit for **achieving continuous improvement and gradual harmonisation** within Europe.

- CG Codes and best practices can deliver **results that are more robust** than a legislative solution. For instance, audit committees were introduced by EU Directives in the middle of the last decade. At that time, the overwhelming majority of UK-listed companies already had an audit committee with fully independent members thanks to the impetus given by the Code.
- CG Codes and best practices **can be easily adjusted**. For instance, gender diversity has been introduced in the UK Code before the UK legislators have addressed the topic. Codes are in fact reviewed periodically. This review exercise is a good opportunity to check the need for adaptation or innovation of the Code, so as to remain in line with (international) best practices while at the same time taking the expertise and feedback of the business world further into consideration.
- CG Codes offer the opportunity to combine swift innovations with flexible introduction into the corporate world, **giving the market the necessary time to adapt** to the new recommendations. For instance, the British CG Code has introduced the concept of external boards' evaluation every 3 years. It would have been impossible to implement an EU regulation requiring external boards' evaluation given that the market was not mature and equipped enough to respond to the demands.
- In the European Union with a vast diversity of cultures and backgrounds, the increasing alignment of CG Codes and best practices facilitates further convergence.

However people should acknowledge that **codes can't deliver immediate**

results. In a self-regulatory environment with CoE flexibility, results come mostly over a period of time. There is a tendency for legislators to be impatient. This combines with social and media pressure. Especially since the financial crisis, regulators have been translating different aspects of governance codes into law (especially in the financial sector).

But also the **courts increasingly refer to the codes** when judging business practices. In the Netherlands, the Code is a reference point, expressing the social principles and reflecting mainstream opinion in the field of good governance. The Code is not incorporated in the legal system but it constitutes a source of inspiration for judges and has an indirect impact, like case law. The Supreme Court has referred to the Code many times; in the case of a merger decided by a board composed mainly of non-independent directors, the Court has judged that the merger decision was hampered by insufficient independence (as prescribed by the Code) and apparent conflicts of interest. In Germany, there is an evolution in the perception of directors' liability: if a director does not comply with the code, he may become liable.

However, **mandatory rules can reduce the focus on the substance of good governance**, pushing attention towards a mere formalistic approach. At the same time, such an approach will remove the key responsibility of boards and shareholders for the quality of governance and reduce governance to a compliance debate with regulators. **The danger is that a formalistic CoE-approach leads to a legalistic board approach**, with no in-depth board discussions on the governance of the firm, but with lawyers and auditors taking over to fulfil the necessary formalities. Lawyers have started drafting explanations. Many institutional investors care mainly about formalities, checking the compliance but not really the substance. If companies are only looking for a formal compliance (box ticking) to avoid discussions with shareholders, that is not positive either. In fact, the more the focus is on formalities, the less people have to think deeper and reflect upon the underlying reality.

The CoE mechanism can only work effectively if boards force themselves to reflect upon their governance, on the rationale behind their governance structures and processes (including behaviour!) and focus on how they can defend the trade-offs and choices they have made.

Towards better qualitative information

The quality of explanation is the core factor for upgrading the legitimacy of the CoE approach. However, defining the 'quality' requirements is not a straightforward exercise. What really are justified reasons for non-compliance and does this differ per type of recommendation? Are structural factors like the size of the company, the maturity level or its main sector of activity a valid explanation and what about the type and/or structure of shareholding? To what extent are temporary deviations acceptable and what time limits should there be? What guidance do companies need in order to be sure that their disclosure is complete? On the other hand, how can transparency be enhanced so as to prevent companies from hiding non-compliance in their corporate governance report? To what extent should the explanations be discussed at the general meeting and be voted upon?

Thinking about the nature and the relevance of the explanations is extremely important. CoE needs to foster a better dialogue between boards and owners in order to make governance better fit the challenges a business firm is confronted with. From the start, corporate governance codes have offered a dilemma to boards of all sorts of companies: the **responsibility of choice**. It is great to have choice but companies must effectively choose. They can't just refer to a code simply because it is a code. Companies have the choice to act differently: therefore they should reflect on taking another route.

The Italian Code states that each company shall provide in the report accurate, concise and easily understandable information on the manner in which each single recommendation has been implemented. It is important to state why an explanation is company specific or to explain why a solution is in the interest of shareholders and other stakeholders or to provide a time horizon for the path towards full compliance.

In 2008, the Swedish CG Code went even further by adding that companies should not only explain for each case of non-compliance but also describe the solutions the companies have adopted instead and address the specific alternative that they see as a valid route to good governance.

The Belgian CG Commission and the British Financial Reporting Council (FRC) have developed frameworks to provide **guidance in order to improve the quality of the explanations**. The aim is to enhance the content of the explanations as well as the process of tailoring the governance and using the flexibility that CoE offers.

The following principles have been recognised by the Belgian CG Commission as a useful guide to provide high-quality explanations:

- Explanations cannot just refer to the fact that a company considers the (recommendations of the) code inappropriate or questions the philosophy behind the code.
- If a company deviates from a provision of the Code, the reasons why must be specified in the Corporate Governance Statement to create more transparency.
- Companies should clearly mention which provisions of the code they are deviating from and then give the explanation.
- A description of these deviations must be submitted to the Board of Directors to verify the quality of each explanation and check whether there are any additional reasons why the company deviates from the Code.
- The Board of Directors must approve the reasons given and endorse their content.
- Explanations must be submitted to the General Assembly when the Corporate Governance Statement is presented.
- This process must be repeated every year.

The FRC has identified other key elements of explanations that should:

- set out the background,
- provide a clear rationale which is specific to the company and specify additional risks that might arise,
- indicate whether the deviation from the Code's provisions is limited in time,
- state what alternative measures the company is taking to deliver on the principles set out in the Code and mitigate any additional risk.

Towards an efficient monitoring of explanations

It has been clear from the very outset that the flexibility offered by the CoE approach could only work effectively if it was sufficiently monitored. Such monitoring should focus on the following three dimensions:

- Is the information available or not?
- Is the information sufficiently accurate?
- Is the information value high enough?

In reality, the European countries have developed quite different practices regarding monitoring and this within a large variety of legal frameworks, leading to quite different degrees of monitoring.

1. Originally, it was assumed that ***shareholders and financial markets*** had a crucial role to play in order to make sure the self-regulatory route resulted in an effective improvement of the governance practices. Every code assumed shareholders would finally be the monitors of the CoE and eventually alert market regulators if the information was not available or if the quality was not sufficient.

However, the basic assumption, that the shareholders and the market should primarily play a monitoring role, might not be as straight forward as hoped or believed. At both ends of the spectrum of listed companies **there might be systemic problems with the monitoring role of shareholders**.

On the one hand, the **more dispersed** the shareholding is, the less shareholders will be tempted to engage intensively with their investee companies. Engagement poses a cost-benefit problem. Why should a financial player engage as an active owner, while the other more passive owners (which might be competing financial investors) profit from any positive outcome of this activism (the so-called free riding syndrome)? Moreover, quite a number of institutional investors are only following the indexes, so there is no incentive whatsoever to develop a form of shareholder activism. The same holds, although for different reasons, for those investors that merely focus on short-term returns, like day traders.

At the other end of the spectrum the **more concentrated** the ownership, the more those blockholders will dominate the board as well as the general assembly of shareholders. As such they define the original governance model, develop and propose the annual governance statement, while at the same time being in a

controlling position to approve that governance statement in the annual meeting. As such there is no check-and-balance. Ultimately, the majority of reference shareholders control themselves.

In between those two extremes, there are models with some more important 'outside' shareholders, primarily being larger institutional investors. But even in this model it might well be that these investors tend to rely on asset managers, analysts and rating agencies to guide them in their voting responsibilities. The more complex this investment chain becomes, the less it will be straightforward that there will be sufficient attention paid to the quality of the explanations. Given the opposition against 'acting in concert', institutional shareholders cannot easily join forces and create a feasible platform for more shareholder activism (and overcome the so-called collective action problem dispersed shareholders are confronted with).

In the meantime, **improvements have been made in terms of quality and quantity of voting activities and engagement of institutional shareholders**. Various 'dedicated' codes have been recently developed fostering a more active monitoring role of institutional investors.

The European Fund and Asset Management Association (EFAMA) adopted a Code in April 2011, stating that Investment Management Companies should have a documented policy available to the public on whether, and if so how, they exercise their ownership responsibilities. The Code also recommends that they should monitor their investee companies, establish clear guidelines on when and how they will intervene with investee companies to protect and enhance value and consider cooperating with other investors, where appropriate, having due regard to applicable rules on acting in concert. They should also exercise their voting rights in a considered way. Finally they should report on their exercise of ownership rights and voting activities and have a policy on external governance disclosure.

At the EU level, the UCITS directive provides policy requirements that these funds engage by actively using their voting rights. Also the initiatives for responsible investment launched by the United Nations are a huge success. Voting engagement and corporate governance represent the first UN-pillar for an active social and governance framework.

The Stewardship Code, as developed and promoted by the FRC in the UK, might well be an important step towards more shareholder activism, or at least a better transparency of the monitoring role of those institutional investors.

It is clear that these codes can be considered relevant for all larger institutional investors, their effects being reflected in the voting turnout at the general meetings of European companies, which has slowly increased, year after year. **However this institutional investors' approach cannot just be copied and pasted in all continental European countries** because of the relatively different situation as to the shareholding structures and typologies. Overall, different monitoring approaches have to be developed in different governance models.

In relation to controlling shareholders, more reflection seems necessary. It is important not to give controlling shareholders a blank cheque. One should not only look for stronger external monitoring but certainly also for giving broader responsibilities to independent directors and minority shareholders when it comes to approving the governance reporting in general and the explanations more specifically.

2 . ***Market or securities regulators*** can be helpful in all jurisdictions because they are responsible for the quantity and quality of the public information. Security regulators basically work in two steps; they start with analysing the governance statements to check whether the necessary information is deficient, weak or not credible, and then in a second step they engage with the company and start one-on-one discussions.

At first, many security regulators were not very keen to start monitoring the compliance with CG codes. But even if such organisations play a monitoring role as to governance, their specific approach differs across Europe. In Spain and Portugal, the Code has been developed by the Securities Regulator, who is in charge of monitoring its implementation. In Spain the corporate governance code was created (in 2006) by a dedicated team led by the Spanish security regulator and they decided to intervene in the drafting of the code because of the very concentrated ownership structure. They decided that the Code should be very prescriptive in order to impose a more demanding benchmark on companies. The Spanish regulator has an enforcement power by which it is competent to require companies to provide more information and to oblige them reformulating their statements before the general meeting. Moreover, they have a sanctioning power in case of false information to the market. In Spain and Italy, where the Corporate Governance Statements are considered regulated information, securities regulators are acting as "transparency enforcer".

In France the codes have been developed by the business federations but the supervisor of the financial market, the AMF, takes care of drafting an annual monitoring report. For the first time, in its 2012 report, AMF uses the "name and shame" approach. In the UK the FRC – an independent regulatory body - is responsible for the drafting and regular updating of the code, but the FSA plays a prominent monitoring role in the financial services sector. Another situation prevails in Belgium where the code has been drafted by a consortium of stakeholders, including the financial market authority (now FSMA). The FSMA only recently started to make more in-depth analysis of compliance with certain parts of the code, including also a detailed analysis of the explanations given.

In companies with controlling shareholders or where the dynamism between shareholders and boards doesn't function that well, securities regulators might be an important component of more independent checks-and-balances.

3 . In many countries ***alternative monitoring*** takes place. An important player in this respect might be the (existing) *CG Commissions*, (in fact, certain countries have set in place such multi-stakeholder organizations), who could become responsible for monitoring the compliance with the governance code. For the time being, they are more engaged in updating the Codes but they could be granted a monitoring role as well. It would be beneficial to combine both responsibilities, because this could allow them to open a dialogue with listed companies and use their feedback for improving the quality of the governance in general and the CoE-approach more specifically. A regular dialogue can help to give more guidance in reaching the goal of good explanations, while at the same time building more legitimacy for using the flexibility offered by opting for a more effective alternative. This could enrich our view on what constitutes a 'best practice' in relative terms, or help in evolving towards a 'best fit' culture.

It is important that these commissions should be composed of senior business people and that their composition should be revised periodically. This was the case for instance in Italy where the structure of the Corporate Governance Committee was revised in 2011. It is not clear whether these Commissions should name and shame companies: there are some risks of liability but it would definitively put pressure on companies.

In the Netherlands there has been a regular change in the commission responsible for the drafting and later on the monitoring of the code. The monitoring commission does not perform the monitoring itself, but relies on external outsourcing, mainly to academic support for their annual exercise.

In Belgium a joint venture between two of the parties involved in the Corporate Governance Commission, the business federation VBO-FEB and the governance and director institute GUBERNA, have undertaken regular monitoring studies of the listed companies' compliance with the code.

In Sweden, the implementation and the monitoring of the code is entirely set through self-regulation and organised by the business sector. The Swedish Corporate Governance Board plays a key role by defining the Code, annually following up and analysing the functioning of the Code. However, there is no enforcement of individual companies' Code application. The Securities Market Council defines Good Practice on the Swedish Securities Market by issuing statements upon request and/or own initiative and interprets Code provisions also upon request. The Stock Exchanges monitor individual companies' Code application as part of general market surveillance activities. Measures in case of inappropriate application begin with dialogue and might end with Disciplinary Committee action. The Swedish Corporate Governance Board does not look whether or not an explanation is a good one from an investor's point of view but reflects if the explanation provides information which is relevant and clear to the shareholders. The Swedish Corporate Governance Board's philosophy is to be strict in terms of the correct application of the code but soft in terms of compliance with individual rules. Its ambition is not to obtain 100% of compliance; in fact the Code would be too weak if everyone complied with all rules.

Numerous other players might intervene in the monitoring of the explanations. *Auditors* have a role to play in respect of controlling the corporate public reporting from a micro perspective, but it is less likely that they can verify the accuracy of what is happening inside the boardroom. The role of peer pressure, of the media and of civil society should not be neglected either. *But also governance experts, service firms, director institutes and the like* often play a role in evaluating the performance of (some) of the listed companies from a more macro perspective. Business firms, like the Big 4 accounting firms or specialised players like Grant Thornton or Heidrick & Struggles make regular analyses of the compliance with governance codes and develop individual benchmarking for their clients. Most of these latter categories of monitoring studies only focus on the largest (index) companies and on a limited number of governance provisions. It should be mentioned that it may be dangerous to extrapolate the conclusions of these limited studies to the overall market situation.

4 . Last, but not least, the *board* has an important role to play in fostering corporate governance and good explanations. Directors are responsible for a true and fair view. But on top of that, the board can ensure adherence to the substance of the Code.

Directors can try stimulating a good explanation culture by using peer pressure. This might be all the more important in those countries that used to work with strict rules and consequently have no experience nor culture to work with flexibility and open norms. Moreover, the (chairman of the) board can stimulate shareholders to play an important governance monitoring role in the shareholder meeting.

The board has to carefully validate the explanations and check whether there are additional reasons why the company deviates from the code. Many observers fear that this duty would be delegated to a subcommittee of the board (composed of independent directors). They claim that this important governance duty has to be performed by the board as a whole. In fact, boards are fragmenting more and more and the board should be kept sufficiently responsible for the total operation of the company. The board should approve the reasons, endorse them and then submit the explanations to the General Meeting to provide transparency and engage into a debate with shareholders.

This brief overview makes it clear that it is advisable that countries further reflect on the best route towards effective monitoring of the compliance with the governance codes in general and the use of the CoE-option more specifically. **Different parties might play a complementary role** to improve the effectiveness of the codes and to make optimal use of the flexibility they offer.

It is obvious that there is no single monitoring model and that there is not one single body that can take care of everything: the monitoring, the enforcement and the development of codes. A solution might be that different parties are involved in checking various elements:

- Availability: regulators are well positioned to check if the information is available.
- Informative value: shareholders have a big role to play, but also governance commissions can critically evaluate and/or guide companies in improving the informative value and the quality of the explanations.
- Accuracy: directors / the board have a role to play to appreciate the quality of explanations.

Towards some conclusions

For some years, the quality of governance in general and of the explanations for not following the recommended 'best practices' specified in corporate governance codes has been a key issue for policy makers, investors, companies and wider society. However, different factors have played a role in the **gradual improvement** of the quality of explanations. A first enhancement factor is the increasing role of the market regulators. Examples in this respect are the annual analysis of a sample of listed companies by the French AMF and its recommendations always expected with interest, and the annual monitoring studies done by the Dutch Monitoring Commission. A second driver of more external monitoring can be found in the oversight role played by other stakeholders. Examples in this respect are the Swedish CG Board, which has monitored the content of the CG reports of the top tier listed companies and the Belgian joint venture between the business federation (VBO-FEB)

and GUBERNA, who regularly examines the compliance with the governance codes by all companies of the large, mid- and small cap index. A third enhancement can be found in the increasing role of statutory auditors. The most striking example here is Sweden where the review of CG reports by external auditors is mandatory. More recently, a number of initiatives have been taken to develop best practices regarding qualitative explanations. Examples are the initiatives taken by the FRC in the UK and by the Belgian CG Commission (giving guidance on the content of the explanations as well as on the process the board should follow to this end).

Notwithstanding that there is some evidence that the quality of explanations and the quantity of the supervision are improving, it is obvious that **more should be done to increase the effectiveness of the governance codes** and to foster a better dialogue between companies and their shareholders. External transparency and accountability are key in building a corporate reputation that facilitates attracting the necessary financial and human resources. Given the self-regulatory approach, a thorough monitoring is **essential to bring about the necessary credibility and legitimacy**.

At the same time we should realise that transparency and monitoring based on this external information are only a first step in the direction of a well-governed company. **Public disclosure and monitoring is a necessary but not at all a sufficient condition**. It is not because we have a board composition that is fully in line with the code's recommendations, that we will make good decisions.

Complementary monitoring capability is best provided by a regular and thorough (independent) governance (or board) assessment. To this end, the requirement in the CG codes to foresee a regular board evaluation is the most important provision. But companies should not only enter into such an evaluation exercise for sake of compliance with the code. On the contrary, they should use this requirement to instil a culture of critical reflection and continuous improvement to make CG a value added for the company.

The whole discussion on CoE is valuable since it creates improved awareness of the complexities and possible dilemmas involved in developing good governance practices, tailored to the specific needs of the company. However the post financial crisis trauma led to an increased scepticism as to the effectiveness of governance codes in general and the self-regulatory approach with CoE more specifically.

In conclusion, people **should not forget that governance is not an end in itself but a means to an end**. Companies should develop a governance model that helps them to reach the corporate goal and allows them to make effective decisions in the long term interest of the company, shareholders and stakeholders. The board is a crucial factor to this end. But also shareholders have to play their role to foster growth, strategy, entrepreneurship and sustainability. These questions should be at the heart of board and shareholder meetings and not the questions of compliance with a governance code. If too much attention is paid to overly formalistic questions in relation to governance compliance, the final goal of governance might be lost: making it a more successful and sustainable enterprise for all and not only a better governance-compliant company.

APPENDIX 1: SPEAKERS AND MODERATORS

Introductory remarks	Patrick Zurstrassen, Chairman, ecoDa
Keynote speech	Prof. Dr. Lutgart Van den Berghe, Executive Director, GUBERNA

The Comply or Explain principle: where do we stand?

Moderator: *Fabrice Demarigny,*
Partner, MAZARS Group, Director of Capital Markets Activities

Eddy Wymeersch,
Chairman, the European Corporate Governance Institute (ECGI)

Jean-Nicolas Caprasse,
Director ISS - Europe, European Governance Head

Jaap Winter,
Partner, De Brauw Blackstone Westbroek.

Practical application of the Comply or Explain in different European countries

Moderator: *Eric Ducoulombier,*
Acting Head of Unit, Unit F-2 - Corporate Governance and Social Responsibility, European Commission, Internal Market and Services DG

Herman Daems,
Chairman of the Commission Corporate Governance Belgium and Chairman of BNP - Paribas Fortis & Barco

Peter Montagnon,
Senior Investment Adviser, Financial Reporting Council

Jaap Winter,
Partner, De Brauw Blackstone Westbroek.

Per Lekvall,
member of the Swedish Corporate Governance Board

Carmine Di Noia,
Deputy Director General, ASSONIME

Ester Martinez,
Head of Corporate Governance Unit, CNMV , Spain

Towards criteria to improve the quality of the explain option

Moderator: *Patrick Zurstrassen,*
Chairman, ecoDa

Prof. Dr. Lutgart Van den Berghe,
Executive Director, GUBERNA

Simon Walker,
Director General, the Institute of Directors (IoD)

Paul Moxey,
Head of Corporate Governance and Risk Management, ACCA

Jesus Casado,
Secretary General, European Family Businesses

Jarkko Syyrila,
Deputy Director General, EFAMA

SPEAKERS' BIOGRAPHIES

CAPRASSE, Jean-Nicolas

Jean-Nicolas Caprasse is Head of Corporate Governance Services for RiskMetrics Group's in EMEA. Jean-Nicolas joined RiskMetrics Group through ISS' May 2005 acquisition of Deminor Rating, where he had been the Managing Partner since 2000 and a partner of Deminor International since 1993.

Prior to joining Deminor, Jean-Nicolas spent five years with JP Morgan, in Brussels and New York, as a Capital Markets Associate. He started his business career with American Petrofina (now Total SA), an oil and gas company in Dallas, Texas, as assistant to the Chief Financial Officer.

He has a degree in Commercial Engineering from Solvay Business School ULB/VUB in Brussels (1986) and an MBA from INSEAD in Fontainebleau, France (1992).

CASADO NAVARRO - RUBIO, Jesus

Jesús Casado is the Secretary General of European Family Businesses, a federation of national Family Businesses Associations from twelve European countries and International Relations Director at Instituto de la Empresa Familiar. Jesús holds a MBA at ESADE Business School (2006-2007) and a Degree in Law and Diploma in Economics (1989/1994) Universidad Pontificia de Comillas ICADE (Madrid). He has also studied at Eberhard Karls Universität Tübingen (Germany) (1994), at the Spanish Diplomatic School (1995/1998) and at Institut de Sciences Politiques de Paris (1997). He is also visiting Professor of Family Business at ESADE Barcelona since 2004.

DAEMS, Herman

Herman Daems is Chairman of the Commission Corporate Governance Belgium, Chairman of the Board of BNP Paribas Fortis and Barco. Until recently, he was Chairman of the Board of Gimv. Herman Daems made a career in academia, policy-making and consulting. He is an Emeritus Professor at the Faculty of Economics and Management of KU Leuven, Belgium.
He chairs the Belgian Corporate Governance Committee which sets, as provided by law, the governance code for boards of listed companies in Belgium. Professor Daems is a member of the executive committee of the VBO/FEB, the Belgian employers association and holds several board positions.

DEMARIGNY, Fabrice

Fabrice Demarigny, a French attorney, PhD in Political Sciences, is a graduate in Law and Economics. Fabrice worked for eleven years in the French Securities Market Authority (AMF) where he was member of the Steering Committee of the College of Supervisors of Euronext and one of the drafters of the IOSCO Principles of Securities Regulation. In 2002, he has been appointed the Secretary General of the Committee of European Securities Regulators (CESR). During his tenure, he contributed to the adoption of all EU Directives and Regulations regarding Markets of financial instruments (Mifid), Prospectuses, Transparency obligations of listed companies, Takeover bids, Market Abuse and UCITS. In 2008, Fabrice became a member of Mazars' international partnership and a partner of Marccus Partners in Paris. He is the Global Head of Capital Markets Activities of Mazars' group. In 2010, he published a report for an "EU listing Small Business Act" at the request of Mme Christine Lagarde, French Minister of Economy. Fabrice is member of the Steering Committee of Paris-Europlace, Chairman of the Securities Lawyers Association (ADB) and Vice-Chairman of the European Capital Markets Institute (ECMI). He is knight of the French National Merit Order.

DI NOIA, Carmine

Carmine Di Noia, 45, is Deputy Director General and Head of Capital Markets and Listed Companies at ASSONIME, the Association of the Italian corporations.

He is, currently, member of the Stakeholder Group at ESMA (European Securities and Markets Authority), the board of the Italian Stock Exchange, the legal committee of European Issuers, the board of the Italian XBRL Association. He chairs the technical secretariat of the Italian Corporate Governance Committee.

He was member of different working groups at the European Commission: the European Securities Market Expert Group (ESME); the Clearing and Settlement Advisory and Monitoring Expert group (the "CESAME" group); the Forum Group on Auditors Liability and the Securities Expert Group on FSAP.

He was also member of the Consultative Working Group on Market Abuse at CESR; of the technical Committee on the Italian Capital Market Forum; of the consultative committee and the advisory board of AIM Italy at the Italian Stock Exchange.

He was, until April 2001, the Head of the Price Sensitive Information Office at Consob, the Italian securities regulator. He joined Consob in 1995 at the Economics department and then the market regulation office.

He teaches Corporate Governance at LUISS-Guido Carli University in Roma where he taught also Financial Market Law and Economics and Monetary Economics.

He holds a Ph.D. in Economics at the University of Pennsylvania (USA), a

Dottorato in Economic Theory and Institutions at the University of Rome, Tor Vergata; a Laurea in Economics at th University La Sapienza, Rome.

He has been author of several articles on financial market regulation and the co-editor of four books in Italian: the Italian edition of "The Prudential Regulation of Banks" by Dewatripont and Tirole; the "Guide to the New Italian Financial Market Law"; "Intermediaries and Financial Markets" and "Companies internal and external control systems".

DUCOULOMBIER, Eric

Eric Ducoulombier graduated in European law at the University of Lille (France). He joined the European Commission in 1992 after having worked several years for an international consultancy and a law firm. He has held various positions in DG Internal Market and Services, mainly in the financial services area. He was for five years Deputy Head of the Unit dealing with Payments Systems, Consumer Policy and Retail Financial Services, in charge of developing the Commission's retail financial services policy and the single euro payments area (SEPA). In April 2010 he joined, as Deputy Head, the Unit of DG Internal Market and Services in charge of Company Law, Corporate Governance and Financial crime. He is currently acting Head of that Unit.

LEKVALL, Per

Per Lekvall was Executive Director of the Swedish Corporate Governance Board from the introduction of the Code in 2005 until May 2011 and is now a regular member of the same body. Prior to this he was Head Secretary of the Governmental Commission on Business Confidence and its sub-commission The Code Group, which developed the Swedish Code of Corporate Governance.

Per Lekvall has extensive experience from a management career in the Swedish forestry group SCA and as an advisor to senior management and boards in major Swedish companies through his consulting practice Boardroom Consulting AB. For about ten years from its start in the mid-1990's he also served as CEO of the national body of the Swedish Academy of Board Directors.

Per Lekvall is a recurrent lecturer at Swedish universities and business schools and has published books and articles on inter alia the role of the board in SME-type companies and corporate governance in Swedish listed companies.

MARTINEZ, Ester

Ester Martínez graduated in Management Sciences at Madrid's Universidad Autónoma and holds a post-graduate qualification in general management from Spain's IESE Business School. She is currently Head of the Corporate Governance Unit at the Spanish Securities Commission (CNMV), where she is responsible for the supervision of the corporate governance and ownership transparency requirements for listed companies. She is also a member of the Corporate Finance Standing Committee of the European Securities Markets Authority (ESMA).

Previously, Ester worked as an auditor for PriceWaterhouse and Banco Santander. She joined the CNMV in 1992 where she has had several responsibilities: International Relations, Head of the Inspection Unit (investment firms), and from 2007 in the Financial and Accounting Department, of which the Corporate Governance Unit is part.

She has wide experience in supervision and policy regarding investment and listed companies. For four years, she held the position of Senior Officer of the Secretariat of the former FESCO (current ESMA). Since joining the CNMV she has served on several panels of experts for IOSCO, CESR and ESMA. She has authored and presented on the "MiFID" Directive and on Corporate Governance of listed companies.

Ester lives in Madrid and is married with three children.

MONTAGNON, Peter

Peter Montagnon joined the Financial Reporting Council as Senior Investment Adviser in May 2010, after almost ten years as Director of Investment Affairs of the Association of British Insurers. Previously Mr Montagnon was a senior journalist on the Financial Times, including spells as Head of the Lex Column and in charge of coverage of the international capital markets.

Mr Montagnon was a member of the European Commission's Corporate Governance Forum from 2005 to 2011. He is past Chairman of the Board of the International Corporate Governance Network and is also a visiting Professor in Corporate Governance at the Cass Business School of the City University, London. He is also a member of the Council of the Royal Institute of International Affairs.

MOXEY, Paul

Paul Moxey is responsible for ACCA's technical position on corporate governance and risk management. He participates in committees and projects on corporate governance and risk around the world and has spoken at major conferences and other events in five continents and written numerous articles and papers.

A qualified accountant and MBA; before joining ACCA, Paul Moxey was a company secretary and group financial controller of UK public companies and later a consultant in governance and risk. The UK Department of Health commissioned him to write much of its corporate governance guidance for hospitals and other health bodies and he worked directly with many, helping them introduce effective governance and risk management.

Paul Moxey has a particular interest in the behavioural aspects of governance and risk – why people do what they do. He co-chairs the Control and Risk Self Assessment Forum and has facilitated many workshops for teams, from board level downwards, in self-assessing their internal control and risk systems. He is also a senior research fellow at Kings College, London.

SYYRILA, Jarkko

Jarkko Syyrilä was appointed Deputy Director General of EFAMA on 1st October 2010 assuming responsibility for regulatory activities. He was a member of the Board of EFAMA since 2008.

Mr Syyrilä joined the Investment Management Association in London in March 2006 as Head of European Affairs, in order to take forward the IMA's initiatives to improve the Single Market on investment management. In 2007 he was appointed Head of International Affairs and in 2008 Director, International Relations.

Since 2004 Mr Syyrilä worked for the Committee of European Securities Regulators in Paris. He was the first Rapporteur of the CESR Expert Group on Investment Management, coordinating CESR's work on e.g. the transitional guidelines for UCITS III, eligible assets of UCITS and simplification of the cross-border notification procedure of UCITS.

He worked for the Finnish Financial Supervision Authority in 1993-2003 on different tasks concerning the regulation and supervision of financial institutions. For the last five years he led the authority's fund supervision unit, which is responsible for supervising the Finnish mutual fund activities and the marketing of foreign collective investment schemes in Finland. He was a member of the UCITS Contact Committee chaired by the European Commission 1997-2003. He was also a member of the Finnish delegation to negotiate the UCITS III Directives at the Council 1998-2001. In 2003 at the Finnish Ministry of Finance he drafted the UCITS III implementation into Finnish legislation. He is co-author of the first legal commentary of the Finnish mutual fund legislation, published in 2001.

Jarkko Syyrilä has a Masters degree in law at the University of Helsinki and in public administration at the University of Tampere.

VAN DEN BERGHE, Lutgart

Lutgart Van den Berghe is Executive Director of GUBERNA (l'Institut des Administrateurs / Het Instituut voor Bestuurders) and Extra-Ordinary Professor at the University of Ghent (B) and the Vlerick Leuven Gent Management School. Her main topic of interest is "Corporate Governance". In the school, she serves as an Executive Director and Chairman of the Competence Center «Entrepreneurship, Governance and Strategy".

She is a Member of the Belgian Commission for Corporate Governance and Non-Executive Director in several international companies, such as CSM (NL), SHV (NL), ELECTRABEL (B) and BELGACOM (B). She is also a Member of the Advisory Board of Lazard (Benelux). At EcoDA (European Confederation of Directors' Association), she is a Member of the Management and chairwoman of its policy committee.

She was a member of the Board of the ING Group (NL, 1991-2003), KLM (NL, 2001 - 2004), Solvay (NL, 2003-2007), Capco NV (B, 2000 – 2003), DVV (B, 1995-1997), member of the Audit Committee of the Flemish Government (B, 2000–2004) and Chairman of the Proximus Foundation (until 2005).

Lutgart Van den Berghe is doctor in Business Economics of the University of Gent (B).

WALKER, Simon

Simon Walker joined the Institute of Directors as Director General in October 2011. Previously he was Chief Executive of the BVCA, the organisation that represents British private equity and venture capital, from October 2007. Between 2003 and 2007 Simon worked at Reuters as Director of Corporate Communications and Marketing. He was previously Communications Secretary to HM The Queen at Buckingham Palace. He was Director of Corporate Affairs at British Airways and a non-executive director of Comair Ltd (South Africa). From 1996-1997 Simon worked as a special adviser in the Prime Minister's Policy Unit at 10 Downing Street.

Simon was a partner at Brunswick, the public relations group, and Director of European Public Affairs for Hill & Knowlton in Brussels. He was a member of the Better Regulation Commission. He is a governor of the environmental foundation, The Hillary Summit and a member of the parliamentary Speakers Advisory Committee on Public Engagement.

Simon was born in South Africa, and has worked as a journalist and consultant in New Zealand, Belgium and the UK. He read Philosophy, Politics and Economics at Balliol College, Oxford, where he was President of the Oxford Union. He was a Knight Journalism Fellow at Stanford University. He is married with two children.

WINTER, Jaap

Jaap (dr. J.W.) Winter (48) is partner at De Brauw Blackstone Westbroek. His practice areas include corporate law and corporate governance. He is professor of international company law at the University of Amsterdam and professor of corporate governance at the Duisenberg school of finance in Amsterdam

Jaap Winter was the chairman of the High Level Group of Company Law Experts that advised the EU Commission and Finance Ministers on the developments of corporate governance in the EU in 2001-2002. Since then he is a member of the European Corporate Governance Forum set up by the EU Commission to advise it on a regular basis on governance developments. He was a member of the Tabaksblat Committee that drafted the Dutch Corporate Governance Code. He received the prestigious ICGN International Corporate Governance Award in 2004.

Jaap Winter has worked with many boards (executive and non-executive) in both advisory and educational capacities. Together with Erik van de Loo and Kees Cools he conducts board reviews, focusing on the interplay between the system and the roles that need to be played on the one hand, and group dynamics and member's individual contribution on the other. They have also initiated academic research into this interplay.

Jaap Winter has published widely on matters of corporate law and corporate governance and often speaks at conferences and other public occasions. He was a member of the Supervisory Board of the Dutch securities regulator AFM and is a member of the Board of Directors of Stichting Comité voor het Concertgebouw, the Supervisory Board of the Mauritshuis and the Supervisory Board of Randstad Holding N.V.

WYMEERSCH, Eddy

Eddy Wymeersch has been Chairman of the Committee of European Securities regulators (CESR) (February 2007-July 2010) and of the European Regional Committee of IOSCO, in that capacity also taking part in the Executive and the Technical committee (2006-2010). He was Chairman of the Belgian Commission Bancaire, Financière et des Assurances (CBFA) (chief executive 2001-2007 and chairman of the supervisory board (2007-2010). He is now chairman of the Public Interest Oversight Board andof the European Corporate Governance Institute. He was member of the European Corporate Governance Forum. He has published on company law, corporate governance and financial regulation and directs the Financial Law Institute at the Gent University

ZURSTRASSEN, Patrick

Patrick Zurstrassen is an independent director. After nearly 30 years of banking and fund management with «Credit Agricole Indosuez» Group, Patrick Zurstrassen founded in Luxembourg «The Directors' Office». He sits on the board of several fund management and investment companies for group such as Lombard Odier, Barclays, Pioneer and Goldman Sachs.

Patrick Zurstrassen has been founding chairman of the Luxembourg Institute of Directors.

He is a member of ICGN, GCGF, ECGI, IDC [USA] and NACD [USA]

APPENDIX 2: MAZARS

Mazars is an international, integrated and independent organisation, specialising in audit, accountancy, tax, legal and advisory services.

Mazars can rely on the skills of 13,000 professionals in the 69 countries which make up its integrated partnership across 5 continents.

Based on its international dimension, Mazars has established itself as a credible alternative, with the ability to offer seamless and custom-made solutions to large corporations, regardless of their country of origin. Thanks to its complete and flexible range of services, Mazars is also a partner of choice for high-growth SMEs and high net-worth individuals.

All Mazars team members share the same obsession with technical excellence and a common determination to go beyond existing technical and ethical standards.

APPENDIX 3: ECODA'S POLICY COMMITTEE AND BOARD

Members of the Policy Committee

Lutgart van den Berghe, GUBERNA, Belgium, chair
Marie-Ange Andrieux, IFA, France
Roger Barker, IoD, UK
Philippe Decleire, ecoDa
Pascal Durand-Barthez, IFA, France
Hana Horak, HUCNO, Croatia
Fernando Iguartua, IC-A, Spain
Sophie Laguesse, ILA, Luxembourg
Per Lekvall, StyrelseAkademien, Sweden
Tomas Lindholm, Directors' Institute, Finland
Gorazd Podbevsek, SDA, Slovenia
Béatrice Richez-Baum, ecoDa
Turid Solvang, Styreinstitutt, Norway

Members of the Board

Patrick Zurstrassen, chair
Maarit Aarni-Sirviö
Juan Alvarez-Vijande
Lars-Erik Forsgardh
Daniel Lebègue
Irena Prijovic
Turid Solvang
Lutgart van den Berghe
Simon Walker

ecoDa's Secretary General

Béatrice Richez-Baum

ecoDa
a.s.b.l.

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