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COMMISSION STAFF WORKING DOCUMENT

IMPACT ASSESSMENT

Accompanying the document

Proposal for a

DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement

and

COMMISSION RECOMMENDATION

on the quality of corporate governance reporting ('comply or explain')

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TABLE OF CONTENT

<u>1.</u>	<u>INTRODUCTION</u>	6
<u>2.</u>	<u>PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES</u>	6
2.1.	<u>EXTERNAL EXPERTISE AND CONSULTATION OF INTERESTED PARTIES</u>	6
2.2.	<u>PROCEDURAL ISSUES</u>	8
<u>3.</u>	<u>POLICY CONTEXT</u>	9
3.1.	<u>NATURE AND SIZE OF THE EQUITY MARKET</u>	9
3.2.	<u>REGULATORY FRAMEWORK</u>	13
3.2.1.	<u>Existing framework</u>	13
3.2.2.	<u>Ongoing developments</u>	14
<u>4.</u>	<u>PROBLEM DEFINITION</u>	15
4.1.	<u>BACKGROUND</u>	15
4.2.	<u>INSUFFICIENT ENGAGEMENT OF INSTITUTIONAL INVESTORS AND ASSET MANAGERS</u>	17
4.3.	<u>INSUFFICIENT LINK BETWEEN PAY AND PERFORMANCE OF DIRECTORS</u>	25
4.4.	<u>LACK OF SHAREHOLDER OVERSIGHT ON RELATED PARTY TRANSACTIONS</u>	29
4.5.	<u>DOUBTS ON THE RELIABILITY OF THE ADVICE OF PROXY ADVISORS</u>	32
4.6.	<u>OBSTACLES TO THE EXERCISE OF SHAREHOLDER RIGHTS</u>	34
4.6.1.	<u>Identification of shareholders</u>	34
4.6.2.	<u>Cross-border transmission of information by intermediaries, including exercise of shareholder rights</u>	35
4.6.3.	<u>Price discrimination by intermediaries for cross-border transmission of information, including exercise of shareholder rights</u>	36
4.7.	<u>INSUFFICIENT QUALITY OF CORPORATE GOVERNANCE INFORMATION</u>	37
4.8.	<u>WHICH STAKEHOLDERS ARE AFFECTED AND HOW?</u>	38
<u>5.</u>	<u>BASELINE SCENARIO, THE EU'S RIGHT TO ACT AND JUSTIFICATION</u>	42
5.1.	<u>BASELINE SCENARIO</u>	42
<u>6.</u>	<u>EU'S RIGHT TO ACT, SUBSIDIARITY AND PROPORTIONALITY, RESPECT FOR FUNDAMENTAL RIGHTS</u>	44
<u>7.</u>	<u>OBJECTIVES</u>	45
<u>8.</u>	<u>POLICY OPTIONS, IMPACT ANALYSIS AND CHOICE OF PREFERRED OPTION</u>	46
8.1.	<u>INCREASE THE LEVEL OF ENGAGEMENT OF INSTITUTIONAL INVESTORS AND ASSET MANAGERS</u>	46

8.1.1.	<i>Description</i>	46
8.1.2.	<i>Analysis of impacts and choice of preferred option</i>	47
8.2.	<u>CREATE A BETTER LINK BETWEEN PAY AND PERFORMANCE</u>	51
8.2.1.	<i>Description</i>	51
8.2.1.	<i>Analysis of impacts and choice of preferred option</i>	52
8.3.	<u>TRANSPARENCY AND OVERSIGHT ON RELATED PARTY TRANSACTIONS</u>	57
8.3.1.	<i>Description</i>	57
8.3.2.	<i>Analysis of impacts and choice of preferred option</i>	58
8.4.	<u>TRANSPARENCY OF PROXY ADVISORS</u>	62
8.4.1.	<i>Description</i>	62
8.4.2.	<i>Analysis of impacts and choice of preferred option</i>	62
8.5.	<u>SHAREHOLDER IDENTIFICATION, TRANSMISSION OF INFORMATION AND INSTRUCTIONS BY INTERMEDIARIES</u>	65
8.5.1.	<i>Description</i>	65
8.5.2.	<i>Analysis of impacts and choice of preferred option</i>	65
8.6.	<u>IMPROVING THE QUALITY OF CORPORATE GOVERNANCE REPORTING</u>	73
8.6.1.	<i>Analysis of impacts and choice of preferred option</i>	74
9.	<u>OVERALL IMPACTS OF THE PACKAGE</u>	76
10.	<u>MONITORING AND EVALUATION</u>	78
	<u>ANNEX I. GLOSSARY</u>	80
	<u>ANNEX II. LIST OF MAIN EU MEASURES IN THE AREA OF CORPORATE GOVERNANCE</u>	82
	<u>ANNEX III. OVERVIEW OF RESPONSES TO CONSULTATIONS SPECIFICALLY DEVOTED TO CORPORATE GOVERNANCE</u>	83
	<u>ANNEX IV. SUMMARY OF AD HOC DISCUSSION WITH STAKEHOLDERS</u>	88
	<u>ANNEX V. MAIN FINDINGS OF THE EXTERNAL STUDY ON MONITORING AND ENFORCEMENT PRACTICES IN CORPORATE GOVERNANCE IN THE MEMBER STATES</u>	93
	<u>ANNEX VI. OVERVIEW OF SITUATION IN MEMBERSTATES</u>	94
	<u>ANNEX VII. ADDITIONAL INFORMATION ON POLICY CONTEXT, PROBLEMS AND DRIVERS</u>	104
	<u>ANNEX IX. IMPACT ON COMPETITIVENESS OF EU COMPANIES</u>	115
	<u>ANNEX XI. LIST OF REFERENCES</u>	118

Executive Summary Sheet

Impact assessment on Proposal for a Directive on encouraging shareholder engagement amending Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies and proposal for a Recommendation on enhancing the corporate governance framework

A. Need for action

Why? What is the problem being addressed?

This impact assessment analyses certain problems in the area of corporate governance of European listed companies. Five main problems have been identified: 1) Insufficient shareholder engagement 2) Insufficient link between pay and performance of directors 3) Lack of shareholder oversight on related party transactions 4) Doubts on the reliability of the advice of proxy advisors, 5) Difficult and costly exercise of rights flowing from shares, 6) Insufficient quality of corporate governance information. These problems lead to suboptimal corporate governance and a risk of suboptimal and/or excessively short-term focused managerial decisions which result in lost potential for better financial performance of listed companies and lost potential for cross-border investment.

What is this initiative expected to achieve?

This initiative should improve the governance and (financial) performance of EU listed companies, contribute to enhancing the long-term financing of companies through equity markets and improve the conditions for cross-border equity investments. This objective should be reached by increasing the level of engagement of institutional investors and asset managers with their investee companies; by creating a better link between pay and performance of company directors; by enhancing the transparency and shareholder oversight on related party transactions; ensuring the reliability and quality of advice of proxy advisors, by facilitating the exercise of existing rights flowing from shares by shareholders and by an improvement of the quality of information on corporate governance provided by companies.

What is the value added of action at the EU level?

Considering the growing importance of cross-border equity investments (some 44% of the total market capitalisation of EU listed companies is held by foreign investors), there is need for targeted EU intervention to address the problems described above. Only a limited number of Member States has undertaken action or is considering doing so, and these actions cannot bring effective solutions to these problems. Action from Member States alone is likely to result in different sets of rules creating an uneven level playing field, which may undermine or create new obstacles to the good functioning of the internal market.

B. Solutions

What legislative and non-legislative policy options have been considered? Is there a preferred choice or not? Why?

A variety of options has been considered to solve the problems, including a no policy change scenario, soft law/recommendation and different degrees of legislative actions. The following preferred options have been identified:

- 1) Shareholder engagement – transparency of institutional investors and asset managers' as regards their voting and engagement policy and investment strategies, together with certain aspects of asset management mandates and their implementation;
- 2) Remuneration – requiring disclosure of the remuneration policy and individual remunerations and submitting it to shareholder vote;
- 3) Related party transactions – requiring additional transparency and an independent opinion on more important transactions and submitting the most substantial transactions to shareholder approval.
- 4) Proxy advisors – requiring disclosure on conflicts of interests and methodology,
- 5) Facilitation of the exercise of existing rights of shareholders – obligation for intermediaries keeping securities accounts to facilitate shareholder identification and the exercise of rights flowing from shares
- 6) Corporate governance reporting – recommendation providing guidance on the quality of reports

Who supports which option?
<p>1) Institutional investors and asset managers' – support by shareholders, institutional investors and companies.</p> <p>2) Remuneration –supported by shareholders, institutional investors, asset managers and proxy advisors, but also companies, provided that the concrete measures remain flexible;</p> <p>3) Related party transactions – support by shareholders especially minority shareholders and asset managers;</p> <p>4) Proxy advisors – support by shareholders, institutional investors, asset managers and companies;</p> <p>5) Facilitation of the exercise of existing rights of shareholders – support by shareholders and companies;</p> <p>6) Corporate governance reporting – shareholders, asset managers, institutional investors and companies.</p>
C. Impacts of the preferred option
What are the benefits of the preferred option (if any, otherwise main ones)?
<p>The benefits of the proposed package of options are difficult to quantify. The package will increase the level of transparency in the equity investment chain, which will contribute to a realignment of interests among actors and a better focus on the long-term interests of final beneficiaries in investment strategies. Moreover, it should give shareholders more effective tools to oversee directors. Proxy advisors' services could gain on reliability. The proposed package is expected to have positive economic effects, as it contributes to an improvement of corporate governance of listed companies and their long-term sustainability. This in turn could have indirect positive social impacts on employees and consumer, i.e. in this case, ultimate beneficiaries of assets institutional investment. No specific environmental benefits are expected.</p>
What are the costs of the preferred option (if any, otherwise main ones)?
<p>The exact costs of the proposed package of options are difficult to quantify. Most options imply improved transparency and disclosure which will create limited additional costs. These costs would be incurred by different stakeholders – listed companies, institutional investors and asset managers, proxy advisors and intermediaries keeping securities accounts. The main costs for companies would be related to the disclosure of the remuneration policy and the remuneration report as well as of the most significant related party transactions and its external evaluation. Only negligible cost would be linked to a shareholder vote on these issues, mostly to take place during general meetings. Companies will also have to pay if they want to benefit from the services of shareholder identification. Some limited costs could also be linked to the improved corporate governance reporting. Costs for institutional investors and asset managers would be linked to the publication of the voting and engagement policies and voting records. Shareholders may see a rise in the costs for an improved service of facilitation of shareholder rights. Some limited costs for proxy advisors would be linked to the publication of their policy regarding conflicts of interests and the methodology for the preparation of advice.</p> <p>There should be no negative social or environmental impacts.</p>
How will businesses, SMEs and micro-enterprises be affected?
<p>The proposed measures would only apply to listed companies. This means that only listed SMEs would be affected and micro-enterprises will not be covered. In principle, there should be no general derogatory regime for the listed SMEs as the proposed rules should be flexible so as to allow companies to adapt them to their situation, but derogations from certain specific requirements could be envisaged. The costs and burden should be limited. There should be a positive impact on the sustainability of listed companies in general, including SMEs.</p>
Will there be significant impacts on national budgets and administrations?
<p>There should be no significant impact on national budgets and administration. The latter would be required to transpose the proposed measures into national law.</p>
Will there be other significant impacts?
<p>Disclosure of individual remuneration might have an impact on fundamental rights (right to protection of personal data of the directors concerned). The package might have an impact on the competitiveness of EU companies, as it might slightly increase their costs and burden, while also enhancing their long-term sustainability.</p>
D. Follow up
When will the policy be reviewed?
<p>The Commission will monitor the implementation of the proposed measures and evaluate their effectiveness. It will consider the need for amendments on the basis of the assessment done five years after the expiry of the implementation period.</p>

1. INTRODUCTION

The past years have highlighted certain corporate governance shortcomings in European listed companies. These shortcomings relate to different actors in the corporate governance of companies: companies' and their boards, shareholders (institutional investors and asset managers), intermediaries and proxy advisors. Companies and their boards have paid remuneration to their directors that was insufficiently linked to performance, concluded related party transactions of which it was not clear whether it was in the best interest of the company, including from a long-term perspective, and have provided corporate governance information that lacked quality. Institutional investors and asset managers have, generally speaking, not sufficiently engaged with companies they invest in, while the advice from proxy advisors to institutional investors and asset managers gave rise to doubts on its quality and reliability, thereby compromising the voting and engagement of shareholders. Finally, intermediaries have, especially in a cross-border context, not always enabled shareholders to exercise their rights in an effective and efficient manner.

On the basis of consultations and research conducted, the Commission adopted on 12 December 2012 an Action Plan on European company law and corporate governance¹ outlining the initiatives to be taken in the coming years in order to modernise the current framework. The main objectives in the area of corporate governance are enhancing shareholder engagement and improving transparency between companies and investors.

This impact assessment considers possible ways to achieve the objectives set out in the Action Plan.

2. PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

2.1. External expertise and consultation of interested parties

In its reflection on the functioning of the European corporate governance framework the Commission has benefited from the advice of the European Corporate Governance Forum.² In addition, an external study on the monitoring and enforcement of corporate governance rules in Member States was performed in 2009.³

A study performed by an external contractor on directors' duties and liabilities evaluates current rules on related party transactions.⁴

Following the financial crisis, the Commission undertook a thorough review of the current corporate governance framework and held two public consultations in line with Commission standards. First, the 2010 Green Paper on corporate governance in financial institutions and

¹ COM(2012)0740 final.

² The Forum was set up in 2004 to examine best practices in Member States with a view to enhancing the convergence of national corporate governance codes and providing advice to the Commission. The Forum comprised fifteen senior experts from various professional backgrounds (issuers, investors, academics, regulators, auditors, etc.) whose experience and knowledge of corporate governance were widely recognized at European level. It provided in particular opinions on as the exercise on shareholder' rights, executive remuneration, related party transactions and significant transactions. The mandate of the forum expired in 2012. For more information, see http://ec.europa.eu/internal_market/company/ecgforum/index_en.htm

³ The RiskMetrics Group, Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States, accessible on http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf. A summary of main findings is attached in Annex V.

⁴ London School of Economics, Study on Directors' Duties and Liabilities, 2013, see especially section 2.5.2. See at http://ec.europa.eu/internal_market/company/board/index_en.htm

remuneration policies⁵ discussed the role of shareholders and in particular the lack of shareholder engagement. A majority of respondents was in favour of mandatory disclosure of voting policies and records by institutional investors.⁶

As regards listed companies in general, the 2011 Green Paper on the EU corporate governance framework contained a chapter on the role of shareholders.⁷ Respondents⁸ were in favour of increasing transparency as regards executive remuneration, of granting shareholders a say on pay and of improving the informative quality of corporate governance reports. They also supported measures regarding monitoring of asset managers by asset owners, more transparency from proxy advisors and reinforcing current rules on related party transactions.⁹ Although there was an overrepresentation of replies from the UK¹⁰, the results of the consultations would have been essentially the same if there were no replies from the UK.¹¹ The low response of public authorities¹² can be explained by the fact that only a low level of shares of European listed companies are held by public authorities in general, namely 4%.¹³

As regards the issue of shareholder identification, transmission of information and facilitation of shareholder rights two public consultations containing questions on these issues were held in line with Commission standards. The responses and two extensive summaries are published on the internet¹⁴. The first consultation in 2009 aimed to collect information on the need to improve the EU-wide framework for securities holding and disposition and how future EU legislation could address the issues identified¹⁵. The Commission got 99 responses. The majority supported the legislative action based on their own experience of the difficulties (but support was heterogeneous and dependent on the respondents' field of business or nationality). All factual information provided is fully integrated in this report, especially with regard to the need for evidence to justify EU action. A second consultation¹⁶ was conducted in 2011 on principles for harmonising EU securities law.

The Commission sent a questionnaire to the Company Law Experts Group¹⁷, which is composed of Member States representatives, on the Member State framework on the issues analysed in this Impact assessment. Moreover, it conducted a number of technical discussions with experts from groups of stakeholders (in particular pension funds, asset managers, issuer companies, retail

⁵ COM(2010) 284 final. See also staff working document SEC(2010) 0669 final. The summary of main responses to the consultation is attached in Annex III. The full feedback statement is available at: http://ec.europa.eu/internal_market/consultations/docs/2010/governance/feedback_statement_en.pdf

⁶ The Green Paper received support the European Parliament, see Report 2010/2009(INI).

⁷ COM(2011) 164 final, for more details see section 2.1 and Annex III.

⁸ The summary of main responses is attached in Annex III. The full feedback statement is available at http://ec.europa.eu/internal_market/company/modern/corporate-governance-framework_en.htm.

⁹ The European Parliament adopted on 29 March 2012 a Resolution on a corporate governance framework for European companies, see point 41, P7_TA(2012)0118: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2012-0118+0+DOC+XML+V0//EN&language=EN>.

¹⁰ 91 out of a total of 409 replies.

¹¹ Moreover, it is noted that due to the size of the UK stock market and the importance of the asset management sector in the UK, UK organisations have an important interest in the corporate governance of EU companies.

¹² 33 out of a total of 409 replies.

¹³ See Observatoire de l'épargne européenne- OEE, INSEAD OEE Data services, Who owns the European economy? Evolution of the ownership of EU-listed companies between 1970 and 2012, August 2012, page 7.

¹⁴ See http://ec.europa.eu/internal_market/financial-markets/securities-law/index_en.htm.

¹⁵ See http://ec.europa.eu/internal_market/consultations/2009/securities_law_en.htm.

¹⁶ See http://ec.europa.eu/internal_market/consultations/2010/securities_en.htm.

¹⁷ The Company Law Expert Group is a Commission Expert Group which provides advice to the Commission on the preparation of Company Law and Corporate Governance measures.

investors, employees, proxy advisors, stock exchanges and regulators).¹⁸ In addition, corporate governance issues were debated during an academic conference on the Action Plan on Company Law and Corporate Governance organised by the European Corporate Governance Institute (ECGI).¹⁹ Finally, some corporate governance problems have been discussed in the Green Paper on the long-term financing of the European economy²⁰ which has initiated a broad debate about how to foster the supply of long-term financing and how to improve and diversify the system of financial intermediation for long-term investment in Europe.

2.2. Procedural issues

The impact assessment was prepared by the Directorate-General for Internal Market and Services.²¹ An Inter-Service Steering Group (ISSG) was set up to follow progress and feed in views from other services of the Commission, including Directorates-General for Enterprise and Industry, Employment, Social Affairs and Inclusion, Taxation and Customs Union, Economic and Financial Affairs, Justice, Competition, Environment, Legal Service and Secretariat General and the European Data Protection Supervisor. The steering group met three times, in February, April and May 2013.

This report was submitted to the Impact Assessment Board, which discussed it on 17 July 2013 and issued an opinion. The comments received from the Impact Assessment Board resulted in the following changes in the revised impact assessment that was finalised on 10 October 2013.

First, to the problem definition additional data were added to identify more clearly the size of the problems. Moreover, the links between the different problems identified in the problem definition were clarified, as were the links with the existing legislative framework and the on-going work of the Commission. With regard to the analysis of impacts, evidence was added to demonstrate the impact of the options. Where possible this evidence is quantitative, but stakeholder opinions were also reported in more details, in order to give insight into the opinions of the different stakeholder groups. Moreover, the potential impact in terms of administrative burden was strengthened. Finally, the effectiveness of the package of measures to solve the problems in the problem description was further analysed.

It should be noted that the part of the impact assessment on shareholder identification, transmission of information and facilitation of the exercise of shareholder rights was initially dealt with in a separate context and was integrated only in the final impact assessment report. For that part, the impact assessment procedures were also followed and the text was cleared by the Impact Assessment Board in April 2013.

¹⁸ The objective was to gather more detailed and technical information on the practical impact of the proposed options on these specific groups. The summary of the discussions is attached in Annex IV.

¹⁹ See the report from the conference, available at: http://www.ecgi.org/conferences/eu_actionplan2013/report.php
²⁰ COM(2013) 150 final.

²¹ The initiative was announced in two roadmaps (No 2013/MARKT/033 and 2013/MARKT/034) available at http://ec.europa.eu/governance/impact/planned_ia/docs/2013_markt_034_shareholders_rights_directive_en.pdf and http://ec.europa.eu/governance/impact/planned_ia/docs/2013_markt_033_corporate_governance_framework_en.pdf

3. POLICY CONTEXT

3.1. Nature and size of the equity market

The European rules on corporate governance apply only to ‘listed’ companies, which are companies that issue securities admitted to trading on a regulated market situated or operating in a Member State.²² It is considered that companies that do not raise money on capital markets should not be subject to the same requirements as listed companies, as there is no need to ensure protection of external investors.²³

There are currently some 10400 listed companies in the EU. The total market capitalisation of EU listed companies is a bit more than 8 trillion euro.²⁴ The size of the market in Member States is very different. The UK stock market is the largest with a market capitalisation of some 2,4 trillion euro, after which come the French stock market with a market cap of some 1,4 trillion euro, the German stock market with 1,2 trillion euro and the Spanish stock market some 780 billion. These four Member States cover 70% of total market capitalisation in the EU and 66% of all listed companies.

The ownership structures in the EU are diverse – while in the UK, Ireland and the Netherlands dispersed ownership of the capital is predominant, in continental Europe the concentrated ownership model is the leading scheme, although there is a clear tendency towards the dominance of dispersed ownership in some Member States.²⁵ For example, only 25% of large cap companies have large block holders in Germany.²⁶ In the dispersed ownership system, there is a “separation of ownership and control” with share ownership being dispersed among many institutional and retail shareholders and no shareholders typically holding significant blocks.²⁷ In the concentrated ownership system, a shareholder, a family group, or a small number of shareholders hold a significant block of shares and often have the power to appoint representatives on the companies’ boards, thus obtaining a certain level of control over its management.²⁸

Listed companies in Europe have a limited number of retail shareholders: only 11% of the market value of shares was owned by individuals in 2011. The largest category of shareholders is foreign investors with 44% of the market value. 23% of the value of shares is owned by institutional investors such as pension funds, insurers and other financial intermediary companies, mutual funds and collective investment companies; 16% by non-financial companies (limited liability companies, foundations etc.), 4% by general government and 3% by banks.²⁹

²² See for example Article 1 of the Directive 2004/25/EC on Takeover bids, the Transparency Directive (2004/109/EC), of the Shareholders’ Rights Directive (2007/36/EC).

²³ Respondents to the Green Paper on the EU corporate governance framework clearly pronounced themselves against the extension of the EU corporate governance rules to unlisted companies.

²⁴ For more details, see Figure 1 in Annex VII. The market capitalisation mentioned only takes into account domestically incorporated companies and not foreign companies listed on the relevant stock exchange.

²⁵ For example Germany, Spain.

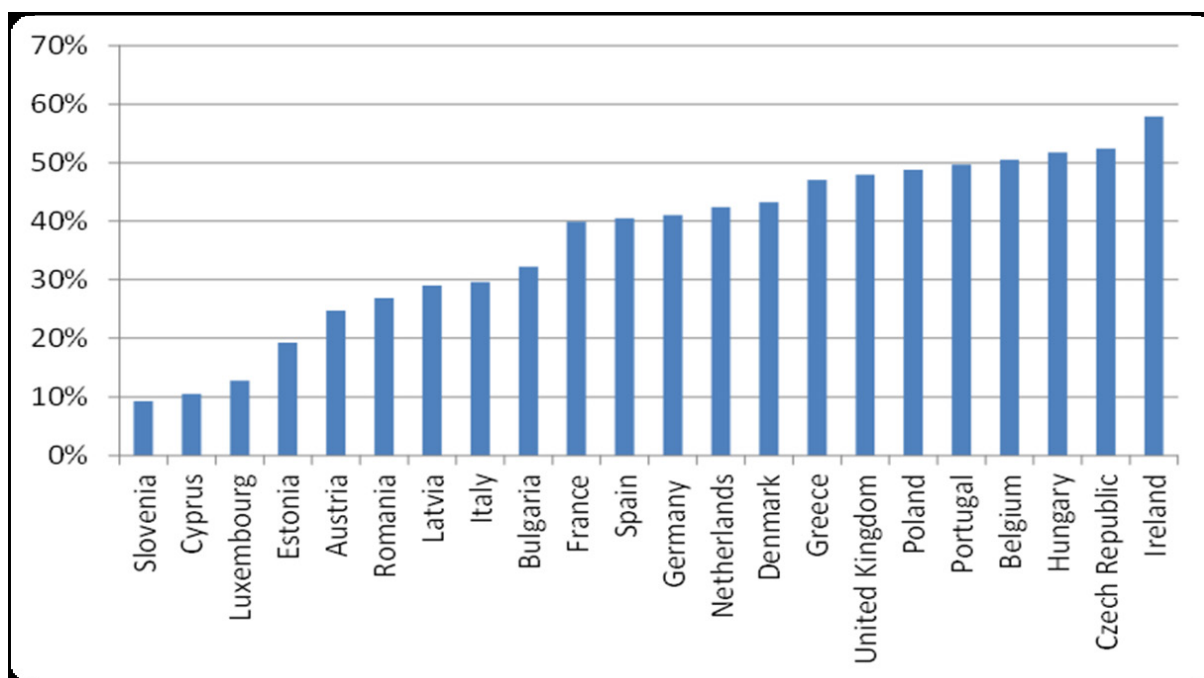
²⁶ Report on the proportionality principle in the European Union, Sherman and Sterling, ISS, 2009. http://ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf

²⁷ See John C. Coffee Jr., ‘Dispersed Ownership: the Theories, the Evidence, and the Enduring Tension Between ‘Lumpers’ and ‘Splitters’, *European Corporate Governance Institute, Law Working Paper* No. 144/2010.

²⁸ Classic agency theory demonstrates that the delegation by the owners of companies of the management of the company results in information asymmetries and leaves room for directors to act in their own self-interest to the detriment of the shareholders. See, for instance, A. Berle, G. Means, *The modern corporation and private property*, Transaction publishers, New Brunswick, 1991; J. E. Garen, *Executive compensation and principal-agent theory*, *Journal of Political Economy* 1994, 102(6), 1175-1199.

²⁹ See for an overview Figure 2, Annex VII. There are however important differences between Member States.

The share of foreign investors in total market capitalisation in the different Member States is depicted in the below figure. For the four Member States with the largest market capitalisation and the largest number of listed companies foreign investors hold between 40 and 50% of the market capitalisation of shares. This percentage of foreign ownership over has gone up from 10% in 1975 to 44% in 2011.³⁰



A large part of the foreign investors are foreign institutional investors and asset managers. Over the last decades the ownership structure of listed companies in most OECD countries has moved from direct ownership to intermediary ownership.³¹ According to the OECD, in 2010 institutional investors and asset managers held nearly half of the shares of listed companies in the world, which would mean that this percentage is considerably higher for shares in free float.³² Institutional investors' share in European companies' capital has increased substantially, which makes them a major force on the stock market; although their importance varies across markets (for example it attains only 6% in Romania but as much as 50% in Germany and Ireland).³³ In total, EU pension funds and insurers have invested more than 4 trillion Euros in equities,³⁴ which equals some 57% of the total market capitalisation of EU listed companies.

As regards the term '*institutional investors*', for the purposes of this impact assessment, it will be used to designate asset owners. *Asset owners* hold assets on behalf of ultimate investors who bear

³⁰ See Observatoire de l'épargne européenne- OEE, INSEAD OEE Data services, Who owns the European economy? Evolution of the ownership of EU-listed companies between 1970 and 2012, August 2012, page 20 and 33.

³¹ Isaksson, M. and S. Çelik (2013), "Who Cares? Corporate Governance in Today's Equity Markets", *OECD Corporate Governance Working Papers*, No. 8, page 25.

³² See Isaksson and Çelik, "Who Cares? Corporate Governance in Today's Equity Markets", p. 20.

³³ For more details, see figure 3 in Annex VII. See also Hewitt, P. (2011), "The Exercise of Shareholder Rights: Country Comparison of Turnout and Dissent", *OECD Corporate Governance Working Papers*, No. 3, page 25.

³⁴ OECD, Institutional investors database, at: <http://stats.oecd.org/Index.aspx?DatasetCode=7IA>. Does not include Cyprus, Malta, Lithuania, Latvia, Romania and Bulgaria. See also the Asset management report 2013 of the European Fund and Asset Management Association, page 3.

the economic risks of the investment. The most typical of these are pension funds, insurance companies, banks and sovereign wealth funds. According to InsuranceEurope total assets under management of insurers are some 8.5 trillion Euro³⁵, of which almost 33% is invested in shares.³⁶ PensionsEurope stated that it represents some 3.5 trillion in assets.³⁷ Many asset owners manage assets in-house, but they increasingly rely on the expertise of external asset managers. An example is that in 2009 approximately 93% of Dutch pension assets were invested externally with one or more asset managers, while this percentage was less than 50% in 2001.³⁸ The Kay report notes that decisions on voting and acquisition and disposal of shares are most often exercised by asset managers.³⁹

Asset managers manage the assets of asset owners and households. They can do so either through investment funds (the most important being Undertakings for Collective Investment in Transferable Securities (UCITS)⁴⁰, or through discretionary mandates. Most assets managed by asset managers are done so by means of discretionary mandates⁴¹, namely 53%.⁴² European asset managers had in 2012 some 14 trillion euro of assets under management. 29% of these are invested in equity. 75% of the assets under management came from institutional investors. From this 75%, 42% came from insurers and 33% of pension funds, which suggest that a very large majority of assets of pension funds and more than half of those of insurance companies are managed by asset managers. Most of these assets are managed in a limited number of Member States, namely in the UK (36%), France (20%) and Germany (10%). For assets managed under discretionary mandate the UK's market share is 47%, for France 19%, the Netherlands and Italy 6% and 4% for Germany.⁴³

³⁵ Reply to the Green Paper on long-term financing of the European economy, page 1.

³⁶ <http://www.insuranceeurope.eu/uploads/Modules/Publications/final-key-facts-2013.pdf>, page 19 and <http://www.insuranceeurope.eu/uploads/Modules/Publications/eif-2013-final.pdf>, page 60.

³⁷ Reply to the Green Paper on long-term financing of the European economy, page 2. According to the OECD's Pension markets in Focus (September 2012), pension fund assets in the Euro area were some 1,54 trillion euro in 2011.

³⁸ See the reply of the Dutch based corporate governance forum for institutional investors in listed companies ("Eumedion") to the Commission's 2011 Green Paper, page 11.

³⁹ The Kay Review of UK Equity Markets and Long-Term Decision Making, Final Report, July 2012, page 6. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/34732/12-917-kay-review-of-equity-markets-final-report.pdf

⁴⁰ UCITS are investment funds that have been established in accordance with UCITS Directive. They provide for a high level of investor protection and can be marketed across the EU. 72% of the assets managed in funds are UCITS. The guiding principle behind the UCITS Directive is that investors in funds authorised under it can get their money back at any time. Investment funds are pools of assets with specified risk levels and asset allocations, into which one can buy and redeem shares, such as UCITS, hedge funds, private equity funds.

⁴¹ In the Markets in Financial Instruments Directive (MIFID) this is called "portfolio management" See article 4 (9) of Directive 2004/39/EC. Discretionary mandates give asset managers the authority to manage the assets on behalf of an asset owner in compliance with a predefined set of rules and principles, on a segregated basis and separate from other investors' assets. MIFID is designed to strengthen the EU legislative framework for investment services and regulated markets with a view to furthering two major objectives: 1) to protect investors and safeguard market integrity by establishing harmonized requirements governing the activities of authorized intermediaries 2) to promote fair, transparent, efficient and integrated financial markets.

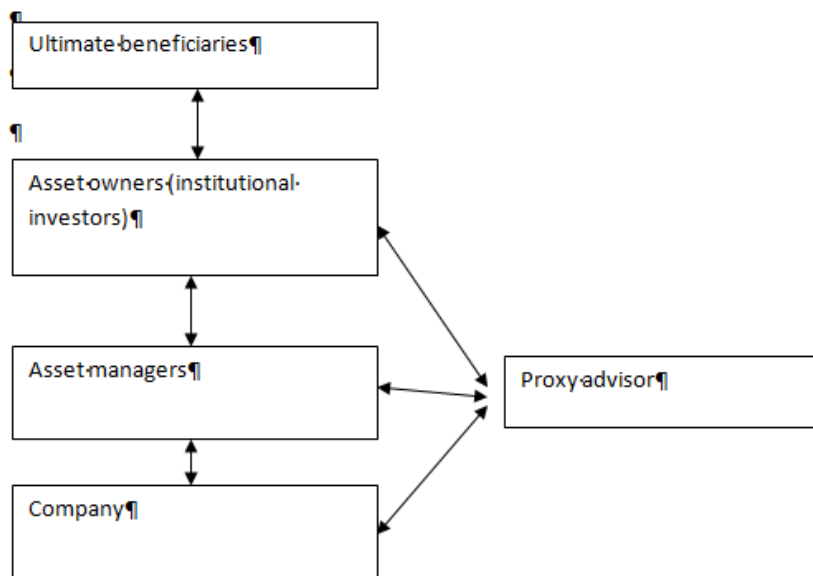
⁴² Discretionary mandate assets represented EUR 7.3 trillion in 2011, whereas investment funds accounted for the remaining EUR 6.5 trillion. See the Asset management report 2013 of the European Fund and Asset Management Association: http://www.efama.org/Publications/Statistics/Asset%20Management%20Report/Asset_Management_Report_2013.pdf, p. 15.

⁴³ See the Asset management report 2013 of the European Fund and Asset Management Association (EFAMA), page 10.

Proxy advisors are important advisors to institutional investors and asset managers, since they provide voting advice to shareholders, which is particularly important for institutional investors and asset managers that hold shares in hundreds or thousands of companies.⁴⁴

A simplified structure of the equity (share) investment chain is described in the schema below. It is important to note that there is no uniform EU definition of a shareholder, so Member States laws define who is entitled to exercise shareholder rights. In case of the use of asset managers generally the asset owners define the general framework for the investment strategy and asset allocation and the terms of the mandate also define who will be entitled to vote as a shareholder.⁴⁵ In practice it is increasingly the asset manager and almost never final beneficiaries, such as future pensioners, insurance policy holders or bank account holders who decide on how the vote should be cast.

Figure 1: schema of the equity investment chain



Shares are held and transferred through a complex, sophisticated and international network of intermediaries. Intermediaries hold securities in an account for someone else, e.g. when an issuer decides to issue securities to the public (investors) it usually hires an intermediary, e.g. investment banking firm. The newly issued securities are then deposited in a Central Securities Depository (CSD) or an International Central Security Depository (ICSD). Banks can also hold and trade securities on behalf of others as intermediaries or on their own books as an investor. Intermediaries, though, do more than just hold the securities for investors. Generally, intermediaries act on investors' instructions to carry out transactions. They channel the rights flowing from the share to the investor (e.g. dividends) and, in cases they are instructed to do so, they exercise the rights attached to the share on behalf of the investor (e.g. voting).

⁴⁴ For instance, one of the world's biggest asset managers holds shares in some 15.000 companies worldwide.
⁴⁵ The International Corporate Governance Networks model contract terms between asset owners and their fund managers ask for such clarification. See <https://www.icgn.org/best-practice>. In practice asset managers play a key role in voting decisions. See the Kay review, page 31.

3.2. Regulatory framework

3.2.1. Existing framework

The EU corporate governance framework is a combination of legislative rules and soft law, in particular corporate governance codes.⁴⁶ While corporate governance codes are adopted at national level, Directive 2006/46/EC promotes their application by requiring that listed companies refer in their corporate governance statement to a code and that they report on their application of that code on a 'comply or explain' basis.⁴⁷ This approach gives companies an important degree of flexibility in their corporate governance, since these national codes are not only adapted to the different national corporate governance models, but in addition companies can deviate from their provisions.

However, some key corporate governance aspects have been harmonised at EU level through directives. Most relevant in this respect is Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies, which contains rules on information provided to shareholders before the general meeting and on the participation and voting in such meetings. According to the Directive a shareholder is a legal or natural person that is recognised as a shareholder under the law of the Member State where the listed company has its registered office (Article 2 and 1(2) of the Directive). Other important acts are the Transparency Directive⁴⁸ which requires issuers of listed securities to provide to investors financial information and information on major holdings, and the Takeover Bids Directive⁴⁹ that provides for common rules for takeover bids, in particular as regards the protection of minority shareholders in cases when control of a company changes hands. Moreover, Directive 2012/30/EU on the capital of companies addresses shareholders' situation in case of capital increase or reduction. Finally, the Commission has adopted a number of recommendations⁵⁰, which deal in particular with the role of non-executive directors and the composition of board committees as well as the remuneration of directors.⁵¹

Stricter corporate governance rules apply to financial institutions. In particular, the new Capital Requirements Directive and Regulation (CRD IV package)⁵², which will replace the existing rules as of 1st January 2014, constitutes a major step towards creating a sounder and safer financial system. In the area of corporate governance, the new provisions concern in particular the composition of boards, their functioning and their role in risk oversight and strategy in order to improve the effectiveness of risk oversight by boards. The status and the independence of the risk management function are also enhanced. Finally, the package strengthens the existing rules on remuneration, by setting a ratio between the variable and the fixed component of remuneration.

⁴⁶ A list of main EU initiatives is attached in Annex II.

⁴⁷ This approach means that a company choosing to depart from a corporate governance code has to explain which parts of the corporate governance code it has departed from and the reasons for doing so.

⁴⁸ Directive 2004/109/EC.

⁴⁹ Directive 2004/25/EC.

⁵⁰ Commission Recommendation 2005/162/EC on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, Commission Recommendation 2004/913/EC fostering an appropriate regime for the remuneration of directors of listed companies and Commission Recommendation 2009/385/EC complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies.

⁵¹ For more information, see Section 4.3.

⁵² Directive 2013/36/EU and Regulation (EU) No 575/2013.

A number of specific EU acts regulate institutional investors and asset managers. In particular, as regards the activity of asset owners, Solvency I⁵³ and II rules are applicable to insurance companies, including life insurance. Solvency II is currently under revision to improve the conditions for insurers to invest in the long-term.⁵⁴ Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (IORP)⁵⁵ regulates pension funds. As regards asset managers, the UCITS Directive⁵⁶, currently under revision⁵⁷ and Directive 2011/61/EU on Alternative Investment Fund Managers (AIFM)⁵⁸ contain rules applicable to management through certain funds, while the Markets in Financial Instruments Directive (MIFID) (Directive 2004/39/EC)⁵⁹, currently also under revision⁶⁰, is applicable to management under discretionary mandates. More details on the provisions relevant for corporate governance can be found in annex XII.

There is no international harmonisation in the field of corporate governance, however the OECD Principles on Corporate Governance⁶¹ of 2004 are considered as a major benchmark in this field.

As regards rules applicable to intermediaries keeping securities accounts for investors and transmit information between companies and investors, the MIFID Directive referred to above is relevant. Central Securities depositories are currently regulated by national law but will be subject to EU regulation in the future (see 2012 Proposal for a Regulation on Central Securities Depositories, currently under negotiation with the Council and Parliament⁶²)

3.2.2. *Ongoing developments*

Among the current initiatives, the revision of the Transparency Directive⁶³ has impact on shareholders, as it modifies the regime of notification of major holdings of voting rights. The recent Commission proposal on disclosure of non-financial and diversity information by certain large companies and groups⁶⁴ aims at increasing EU companies' transparency and performance on environmental and social matters, but also on risk management and diversity in company boards, and, therefore, to contribute to sustainable growth and employment. The Commission also proposed a regulation on European Long-term Investment Funds (ELTIF). The ELTIF allow investors to put money into companies and projects that need long-term capital. It is aimed at

⁵³ Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance.

⁵⁴ Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance. Solvency II is an economic, risk-based solvency regime for insurance companies in the EU. Solvency II is currently under revision through the so called "Omnibus II" Directive. This includes a new so called "long-term guarantees package" which introduces adjustments to the existing framework that will support overcoming regulatory distortions to long-term business and investments triggered by short-term volatility in financial markets. This should improve the conditions for insurance companies to invest in the long-term. It is expected that the Omnibus II Directive will be concluded before the end of 2013 and that Solvency II (including the Omnibus II provisions) shall apply from 01.01.2016.

⁵⁵ Directive 2003/41/EC.

⁵⁶ Directive 2009/65/EC.

⁵⁷ COM(2012) 350 final.

⁵⁸ Directive 2011/61/EU.

⁵⁹ Directive 2004/39/EC.

⁶⁰ COM(2011) 656 final and COM(2011) 652 final.

⁶¹ Available at <http://www.oecd.org/daf/ca/corporategovernanceprinciples/31557724.pdf>. The principles cover in particular shareholders' rights and their exercise, equitable treatment of shareholders and protection of minority shareholder, as well as institutional investors.

⁶² Proposal for the regulation:

<http://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52012PC0073:EN:PDF>

⁶³ COM(2011) 683 final

⁶⁴ COM(2013) 207 final

investment fund managers who want to offer long-term investment opportunities to institutional and private investors across Europe, e.g. in infrastructure projects. However, this proposal targets long-term investments in non-listed companies.⁶⁵

The so called "Omnibus II" Directive was adopted at the end of 2013 and would amend the solvency regime for insurance companies. The Omnibus Directive includes a new so called "long-term guarantees package" that will support overcoming regulatory distortions to long-term business and investments triggered by short-term volatility in financial markets. This should improve the conditions for insurance companies to invest in the long-term. The new regime would apply from January 2016.

Furthermore, the Commission has recently presented a follow-up to the Green paper on long-term financing of the European economy, which includes a number of measures to improve the regulatory framework and incentives for long-term investments. It proposes a transparency measure to incentivise institutional investors and asset managers to take better account of environmental, sustainability and governance information (ESG) in their investment decisions. This measure would be complementary to this proposal as it would also aim at incentivising institutional investors and asset managers to take better account of the medium to long-term interests of their end-beneficiaries and of the companies they invest in when defining and executing investment strategies and awarding asset management mandates. It would thus also contribute to more responsible share-ownership.

4. PROBLEM DEFINITION

4.1. Background

This impact assessment analyses a number of problems in the area of corporate governance. Corporate governance is traditionally defined as a set of relationships between a company's management, its board, shareholders and other stakeholders.⁶⁶ One of the key issues in corporate governance is the separation between ownership and control and the resulting principal-agent relationship between shareholders and directors. Classic principal-agent theory demonstrates that the fact that shareholders ("principals") delegate management of the company to the directors ("agents") leads to information asymmetries⁶⁷ and leaves room for these directors to act sometimes more in their own self-interest than in the interest of the shareholders. This could lead to suboptimal corporate governance and suboptimal financial performance of companies.

Good corporate governance is in the first place a responsibility of listed companies themselves, but there is, like in any governance system, a need for checks and balances. If not, directors 'mark their own homework', which often leads to non-objective assessments of their own performance. Shareholders, in particular institutional investors and asset managers, but also other stakeholders like employees, play a key role in providing, from their different perspectives, checks and balances. The precise checks and balances differ however from Member State to Member State.

⁶⁵ COM(2013)462 final. See recital 22 of this proposal.

⁶⁶ See, for instance the OECD Principles of Corporate Governance, 2004, p. 11, at <http://www.oecd.org/daf/ca/corporategovernanceprinciples/31557724.pdf>. A glossary of main terms is attached in Annex I.

⁶⁷ Where managers are better informed about the impact of their personal work on company performance than shareholders.

Changes in the equity investment chain, in particular the increased role of intermediaries and increased cross-border shareholdings, have exacerbated the existing principal-agent problem and have contributed to a lack of shareholder engagement with investee companies and have made the identification of the shareholder, the transmission of information to shareholders and the exercise of shareholder rights more difficult and costly. These changes in the equity investment chain make it necessary to look beyond the mere relation between shareholders and the listed company.

Shareholder engagement is generally understood as the active monitoring of companies by shareholders, engaging in a constructive dialogue with the company's board, and using shareholder rights, including voting, to improve the governance and financial performance of the company. Whether the corporate governance of listed companies' functions well depends, amongst others, on the engagement of shareholders and use of their rights.

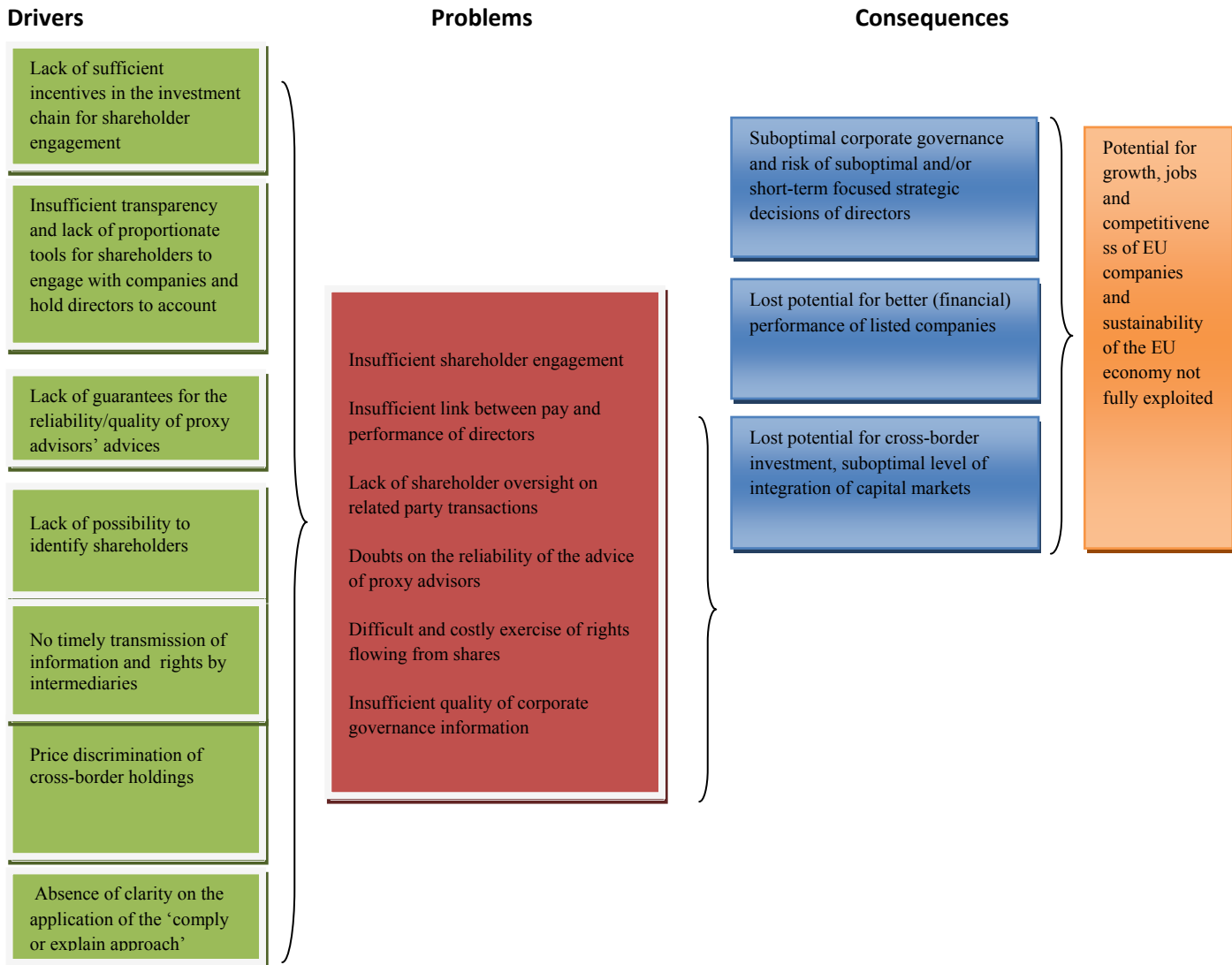
In this regard the question is whether institutional investors and asset managers are interested at all to engage on corporate governance of listed companies: Stakeholders indicate that asset managers are, on purpose or not, often not incentivised by the asset owner to engage on companies' corporate governance and performance. Moreover, such engagement is more difficult with large number of (cross-border) holdings, since it presupposes more detailed knowledge on (all) these companies and their corporate governance, but also on the national corporate governance framework applicable to them. However, Member States' themselves have given shareholders important tools, for instance on remuneration and on related party transactions, and shareholders themselves ask for more tools.⁶⁸ Finally, there is a growing group of investors that opt for an engagement investment strategy. Academic studies underpin these decisions, since they demonstrate that such strategies lead to increased performance of both investments and of investee companies.

The extent to which institutional investors and asset managers will decide to engage more with investee companies depends, amongst others, on the costs and difficulties attached to it. Consultations and extensive informal meetings have shown the Commission in which areas stakeholders see particular problems and where they cannot, due to a lack of comprehensive, clear and comparable information or proportionate tools, engage. Secondly, whether institutional investors and asset managers will engage depends on whether they have incentives to do so. For this reason this impact assessment looks at two distinct, but closely related problems: on the one hand the lack of good and reliable information on EU companies' corporate governance and proportionate tools to engage and on the other hand the lack of engagement of institutional investors and asset managers.

The problems, their drivers and their consequences are depicted graphically in the following problem tree and are described more in detail below. It should be noted that the analysis of the problems described below is constrained by the scarcity of statistical data and by the confidential nature of some of the evidence available to the Commission.

⁶⁸ See for more details the different description of the problems in this chapter..

Figure 2: problem tree



4.2. Insufficient engagement of institutional investors and asset managers

The financial crisis has revealed that shareholder control did not function properly in the financial sector. Rather than ensuring good decision-taking by companies, shareholders, especially institutional investors, have often been either absent or did not take action against or even supported excessive, short-term risk taking.⁶⁹ Listed companies in general do not have markedly different shareholders than financial institutions and there are signs of a lack of sufficient long-term oriented shareholder engagement here too.

A recent OECD report considered that 'the current level of "monitoring" of investee companies by institutional investors is sub-optimal' and that a great deal can be done by private agents and policy makers to improve the corporate governance outcomes of institutional investors behaviour".⁷⁰ A UK government commissioned study, the Kay review, concluded that "short-

⁶⁹ See results of the study *Corporate governance in the 2007-2008 Financial Crisis: Evidence from Financial Institutions Worldwide*, David H. Erkens, Mingyi Hung, Pedro Matos, January 2012, discussed in section 4.2

⁷⁰ OECD, The role of institutional investors in promoting good corporate governance, p. 10. Available at <http://www.oecd.org/daf/ca/theroleofinstitutionalinvestorsinpromotinggoodcorporategovernance.htm>.

termism” of investors is a problem in UK equity markets, and that the principal cause of this is the misalignment of interests between asset owners and asset managers. According to this study equity markets currently encourage exit (the sale of shares) over voice (the exchange of views with the company) as a means of engagement, replacing the concerned investor with the anonymous trader. Moreover, the study pointed also to increased foreign shareholding, which would have reduced the incentives for engagement and the level of control enjoyed by each shareholder⁷¹: shareholders hold, generally speaking, smaller (minority) holdings in listed companies and it is, for cross-border investors, more difficult and costly to engage with these companies, while the relative benefits of engagement are shared with more investors. The data on the concentration of asset management in a limited number of Member States show the cross-border relevance of this problem.

The problem analysed in this chapter is the lack of engagement of institutional investors and asset managers. This lack of engagement leads to suboptimal corporate governance of listed companies, a risk of short term focused strategic decisions and lost potential for better financial performance of listed companies. Studies demonstrate that shareholder engagement on corporate governance issues is not only creating value for the shareholders⁷², but contributes also to a significant improvement of the governance, operating performance, profitability and efficiency of the investee companies.⁷³

Looking at the current level of shareholder engagement, the most common form of shareholder engagement is voting in general meetings.⁷⁴ With regard to this means of engagement studies show that average turnout is around 60% in Europe. However, the turnout of minority shareholders (typically (foreign) institutional investors and asset managers) is a mere 37%, while average dissent regarding resolutions is around 2-3%.⁷⁵ Where minority shareholders do vote, they typically rely heavily on proxy advisors, especially in case of cross-border holdings. In the USA⁷⁶ average turnout is some 81% and in Japan some 74%. The relatively low turnout at general meetings in Europe can be explained by the relatively high level of foreign share ownership.⁷⁷ Furthermore, the low level of dissent in general meetings of shareholders may also be an indication of a suboptimal level of shareholder engagement.

After voting in general meetings the most commonly mentioned forms of shareholder engagement are private engagement and collaboration with other shareholders. Among the most responsible investors surveyed in 2012, only 39% claim to engage in private with companies. There is however no extensive data available on these means of engagement by shareholders,

⁷¹ Kay review, page 10.

⁷² Elroy Dimson et al, *Active Ownership*, 2012 analyses the positive effects of shareholder engagement on environmental, social and governance matters. As regards corporate governance themes, the cumulative abnormal return of a successful engagement over a year after the initial engagement averages + 7.1%. See similar results about the return generated by an active UK investor in Becht et al, 2009, *Returns to shareholder activism: Evidence from a clinical study of the Hermes UK Focus Fund*, review of Financial Studies 22.

⁷³ Elroy Dimson et al, *Active Ownership*, 2012 finds significant improvements as to return on assets, profit margin, asset turnover and sales over employees ratios after successful engagements.

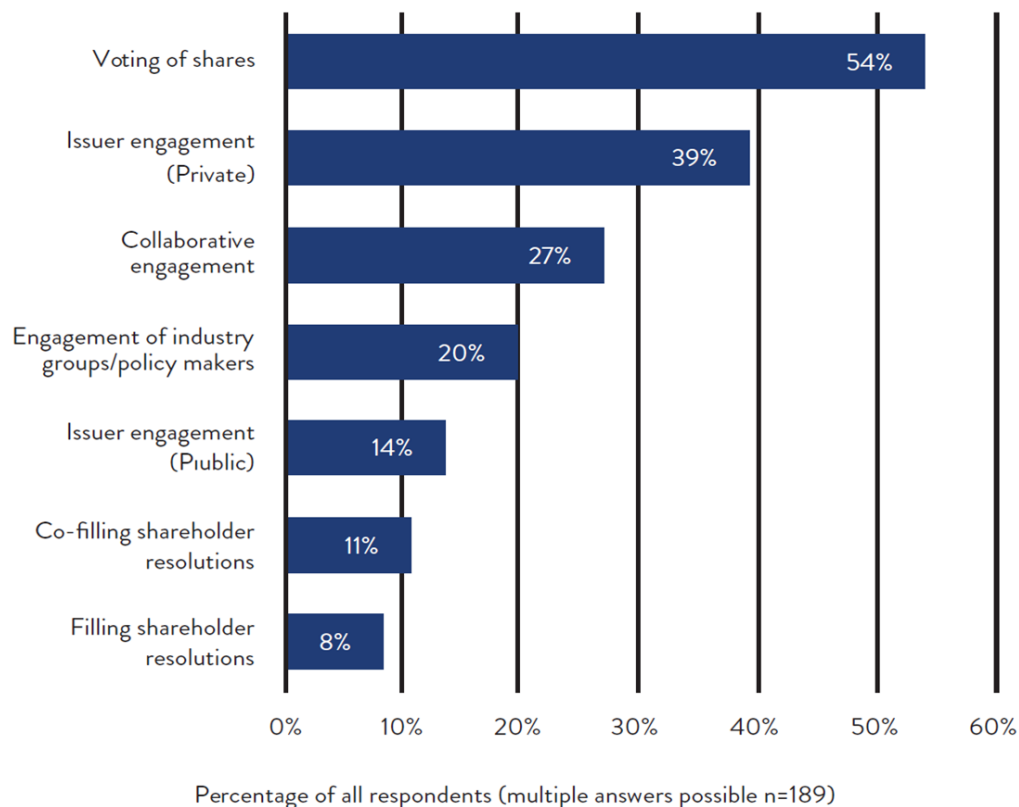
⁷⁴ Eurosif, *Shareholder Stewardship, European ESG Engagement Practices 2013*, page 32.

⁷⁵ See Hewitt, “The Exercise of Shareholder Rights: Country Comparison of Turnout and Dissent”, . The ISS “2010 Voting Results Report. Europe”, shows an average turnout of 61.5% in 2010.

⁷⁶ In the US, certain institutional investors and asset managers interpret the relevant laws as requiring to vote in general meetings. It has been argued therefore vote for at compliance reasons and largely follow the recommendations made by proxy voting agencies. See Charles M. Nathan and Parul Metha, Latham & Watkins LLP, 2010 “The Parallel Universes of Institutional Investing and Institutional Voting”, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1583507

⁷⁷ Hewitt, *The Exercise of Shareholder Rights: Country Comparison of Turnout and Dissent*, page 16.

which can be explained by the fact that such engagement is not necessarily recorded.⁷⁸ The below figure gives an overview of investors' use of engagement strategies.⁷⁹



The proportion of assets managed under engagement and voting strategies is still relatively small compared to other investment strategies in Europe.⁸⁰ According to the European Sustainable Investment Forum (Eurosif), engagement and voting strategies⁸¹ now represent less than 2 trillion Euros⁸² in Europe, compared to 14 trillion Euros of assets under management by asset managers. In the last two years this number increased however with 8,1%. It is to be noted that almost three quarters of this 2 trillion euro concern assets under management in the UK and the Netherlands.⁸³ Recently, the Norwegian sovereign wealth fund, that, according to the Economist, on average holds 2,5% of every European listed company, was reported as having decided to take a more

⁷⁸ Article 14 of the Shareholders Rights Directive obliges companies to establish the voting results of general meetings.

⁷⁹ See Eurosif, Shareholder Stewardship, European ESG Engagement Practices 2013, page 32. The study does not clarify how often or intense they engaged, nor for which part of their assets.

⁸⁰ As to the magnitude of engagement and voting strategies in Europe, it is not easy to give exact data, since the data available for measuring the magnitude of shareholder engagement strategies combine engagement for environmental and social purposes and often do not separate governance matters.

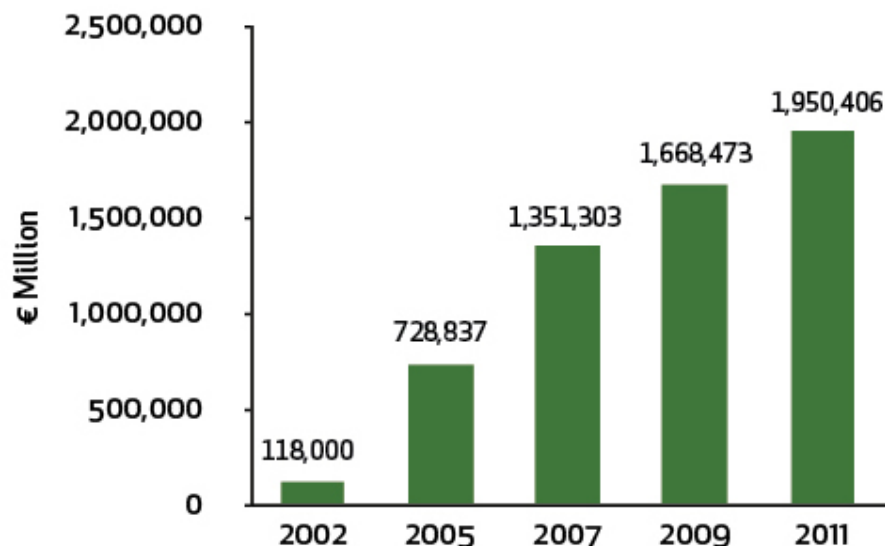
⁸¹ This is defined as “Engagement activities and active ownership through voting of shares and engagement with companies on (environmental, social and governance (ESG) matters”. European Sustainable Investment Forum, 2012 study on responsible investments in Europe, page 17-18. See http://eurosif.org/images/stories/pdf/1/eurosif%20sri%20study_low-res%20v1.1.pdf. This figure measures the assets covered by an engagement policy, not the portfolio value of all companies actively engaged with. Includes only 14 Member States.

⁸² Includes only 14 Member States.

⁸³ Investors will often have an engagement policy covering most of their assets, but will actively engage only on a small number of companies in relation to the total number of companies held.

active role in managing its portfolio of companies and push them to improve their corporate governance.⁸⁴

Figure 5: Growth of engagement and voting strategies in Europe⁸⁵



In a recent Dutch survey, Dutch listed companies were asked how they perceive engagement of shareholders. Only 30% of Dutch institutional investors are perceived to have a dialogue with the company.⁸⁶

There is however a rising interest in responsible investing, which typically aims at maximising financial return by integrating a wider range of long-term risk and return factors, such as environmental, social and governance matters into the valuations of companies ('Integration strategies'). Using data from 9 European countries, Eurosif finds that almost 70% of all engagement assets (2 trillion) are subject to such integration.⁸⁷

The UN Principles for Responsible Investing gave further impetus to the development of responsible investing when adopted in 2006. Responsible investors "seek a sustained competitive advantage and outperformance, partly by evaluating a company's overall management ability to adapt to dynamic business climate and create enduring value"⁸⁸. They are interested in the long-term value of companies and are said to exhibit active ownership which entails shareholder engagement.⁸⁹ Many UN PRI signatories are European asset owners and asset managers.⁹⁰ The

⁸⁴ The Economist, 14 September 2013, "More Money than Thor. Changes to Norway's gigantic sovereign-wealth fund will be felt around the world", See <http://www.economist.com/news/business/21586268-changes-norways-gigantic-sovereign-wealth-fund-will-be-felt-around-world-more-money>

⁸⁵ Eurosif, European SRI study, 2012

⁸⁶ See Dutch Monitoring Committee of the Corporate Governance Code, Fourth report on compliance with the Dutch corporate governance code, 2012.

⁸⁷ Shareholder Stewardship, European ESG Engagement Practices 2013.

⁸⁸ Sustainable Investing, Establishing Long-term value and performance, 2012, DB Climate Change advisors, page 21.

⁸⁹ Although over 85% of asset owners have at least some funds that are passively managed. See the OECD report on the role of institutional investors in promoting Good Corporate Governance.

⁹⁰ The UNPRI reports in 2011 that "in the global market as a whole, ESG integration is being implemented across 8% of listed equities in developed markets".

reporting system for signatories does at this moment however not allow seeing how much shareholder engagement takes place by signatories.⁹¹

The most recent survey (2013) of the UK association of pension funds⁹² reports that 82% of respondent pension funds agreed that ESG factors can have a material impact on their fund's investments in the long-term. The survey also reports about an increasing interest of being more active owners: 56% of respondents agreed that institutional investors had played an active enough role in their investee companies, compared to 50% in 2012 and 54% agreed that engagement had added (or prevented loss of) value to the fund (53% in 2011 and 2012). The survey demonstrates that respondents see more evidence of engagement activities influencing changes on corporate governance issues (such as board composition, remuneration, corporate strategy and performance) than on social and environmental issues⁹³.

At EU level the recently adopted Commission proposal on disclosure of non-financial and diversity information by certain large companies and groups will increase the transparency on environmental, social and some governance matters (diversity and risk management) and will therefore give shareholders important material to engage with listed companies. However, it does not give further tools to shareholders, nor does it aim to make shareholders more engaged.

The main driver for an insufficient level of shareholder engagement appears to be the incentives within the equity investment chain which do not sufficiently encourage increasing the value of the investments through shareholder engagement and creating real economic value stemming from increased efficiency and competitiveness of the investee companies. Asset owners make more and more use of asset managers. Delegation of asset management to asset managers creates an agency problem.⁹⁴ Asset managers have access to more and better information than the asset owners that make use of them and the interests and objectives of agents may differ from those of their principals. Although they have different portfolio horizons, the largest asset owners, such as pension funds and insurers are inherently long-term oriented as their liabilities are long-term.⁹⁵ However, for the selection and evaluation of asset managers they often rely on benchmarks, such as market indexes. Underperformance relative to the benchmark index may lead to the termination of the asset management mandate⁹⁶, while the performance is often evaluated and

⁹¹ According to the European Sustainable Investment Forum, investing taking into account long-term sustainability factors (environmental, social and governance, ESG) is on the rise. In 2011, 3.2 trillion of assets being managed in Europe have taken ESG factors into account when investing (compared to a total of 14 trillion of assets being managed). This number was 2.8 trillion in 2009.

⁹² http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/0354_NAPF_engagement_survey_2013.aspx

⁹³ Page 23 of the above NAPF survey.

⁹⁴ Paul Woolley, The future of finance and the theory that underpins it, Chapter 3, Why are financial markets so inefficient and exploitative – and a suggested remedy, in Adair Turner and others (2010), *The Future of Finance: The LSE Report*, London School of Economics and Political Science, page 125.

⁹⁵ In their contribution to the Green paper on long-term financing, Insurance Europe states that insurers' investment in long-term assets is a natural consequence of their liabilities, that is investing in assets is not an aim per se, but a consequence of insurers' primary role of providing protection and managing policyholders' savings. Pensions Europe argues that the match with the long duration and maturities of their liabilities, often amounting to as much as 10-25 years, makes pension funds very suitable long-term investors. It should however also be noted that pension funds and insurers have short term obligations, which means that they have to find a balance between short-term and long-term performance.

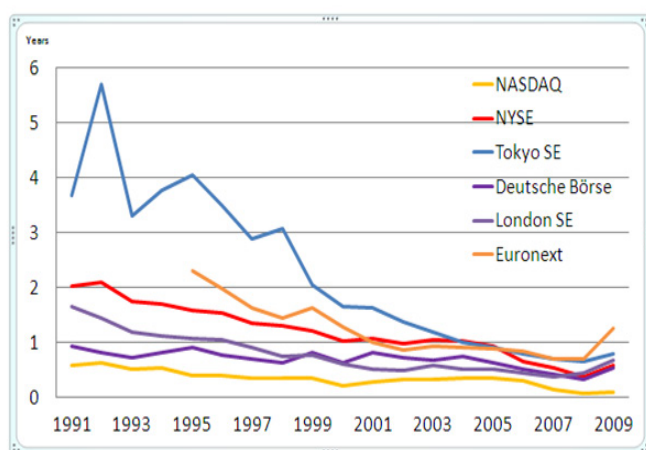
⁹⁶ OECD, The role of institutional investors in promoting good corporate governance, p. 45, see also Eumedion position paper on engaged share ownership, March 2010.

discussed on a quarterly basis.⁹⁷ Furthermore, performance fees for individual fund managers are, to varying degrees, linked to performance versus a standard industry benchmark.⁹⁸

As a result, although asset owners have an important interest in the long-term absolute performance of their assets, many asset managers' main concern has become their short term performance relative to a benchmark, while they have an incentive to outperform each other on the shorter-term. Moreover, the fact that the performance horizon on which the asset manager is often evaluated is short, is a disincentive to engage, because shareholder engagement usually bears fruit only over a longer period of time⁹⁹, while the benefits of engagement will be shared with other shareholders.¹⁰⁰ Short-term incentives turn focus and resources away from making investments based on the fundamentals (strategy, performance and governance) and longer term perspectives, from evaluating the real value of companies and increasing their value through shareholder engagement.¹⁰¹

One indicator of the short performance horizon of shareholders is the average holding period of shares which now stands at some 8 months (see figure 2).

Figure 2. Average Holding Period - Selected Exchanges¹⁰²



In view of the existence of high frequency trading this figure may however not be the best indicator for short-termism of traditional longer-term asset owners and managers.¹⁰³ Looking at

⁹⁷ See the reply of EFAMA to the Green paper on long-term investment of the European economy, page 25 and the Kay review, page 40.

⁹⁸ Mercer, Global asset manager fee survey 2012, page 18 <http://www.mercer.com/articles/1505185>.

⁹⁹ Elroy Dimson et al, Active Ownership, 2012 analysing the engagement actions of a large US asset owner between 1999-2009 finds improvements as to return on assets, profit margin, etc. one year after successful engagements.

¹⁰⁰ The Kay review, page 42: noted that 'In the current market environment both analysis and engagement have something of the character of public goods – most of the benefits accrue to people who do not undertake them.'

¹⁰¹ The shorter the timescale for judging asset manager performance, and the slower market prices are to respond to changes in the fundamental value of the company's securities, the greater the incentive for the asset manager to focus on the behaviour of other market participants rather than on understanding the underlying value of the business. This may result in following short-term movements in market prices (momentum strategies), trading frequently and/or not to allow the performance of the investor diverge too much from the benchmark, so that investment decisions are taken on the basis of the structure of a certain benchmark. Robert Schiller, the 2013 Nobel price winner in Economics demonstrated that stock prices are much more volatile than their fundamental value would suggest. See his "Do Stock prices move too much to be justified by subsequent changes in dividends?" The American Economic Review, 1981 page 421, 422.

¹⁰² See OECD Discussion Note. Promoting Longer-term investment by Institutional investors: selected issues and policies, page 6.

data about deviations from expected levels of portfolio turnover (i.e. the frequency of buying and selling stocks) of traditional longer term asset managers provides a better picture about the magnitude of short-termism of traditional asset managers. When portfolio turnover rates exceed their expected range by a notable margin, this could be an indicator of a lack of conviction in investment decisions and momentum-following behaviour.

A recent study¹⁰⁴ examined the differences between planned and actual turnover rates.¹⁰⁵ Of 822 fund strategies between 2006 and 2009¹⁰⁶, nearly two thirds considerably exceeded their expected turnover levels. Average annual turnover was 72% with some 20% of funds being above 100% which implies a full turnover of the entire portfolio in one year or less. Less than 10% of asset managers have less than 33% of turnover, the equivalent of a three year investment horizon. 65% exceeded their expected turnover by approximately 30% on average.¹⁰⁷ The study concludes that short-termism exists and managers do not necessarily behave according to their stated approach.¹⁰⁸

At EU level there are currently a limited number of provisions that ensure a certain transparency on the engagement and voting policies and their application in practice of asset owners and managers.¹⁰⁹ As regards transparency of asset managers, for assets managed through discretionary mandates (53% of the market), regulated by MIFID¹¹⁰, and where there is potentially the biggest scope for improvement for giving better incentives for shareholder engagement¹¹¹, there is only a limited rule on disclosure about investment strategies and costs to investors. For assets managed in funds (47% of the market) both the UCITS and the AIFM Directive require that these funds set up a strategy for the exercise of voting rights, but they are only required to make a short description of these strategies available to investors on their request.¹¹² There are some rules on the disclosure of the costs of asset management too.¹¹³ In sum, these provisions do not ensure a sufficient transparency of the large majority of asset managers towards institutional investors, nor of institutional investors towards final beneficiaries, which contribute to informed decision taking. In practice, a survey under 189 institutional

¹⁰³ High frequency traders now account for some 30-40% of trading in Europe, although they represent only a very small portion of the ownership. See OECD, *The role of institutional investors in corporate governance*, p. 35 and 43

¹⁰⁴ Mercer, IIRC Institute 2010, *Do managers do what they say?*
<http://www.iircinstitute.org/projects.php?project=42>, page 7.

¹⁰⁵ It has to be emphasised that this study examined the behaviour of active equity managers which traditionally operate with a longer investment horizon and excluded hedge funds and other long/short strategies.

¹⁰⁶ We have to acknowledge that this period was historically very volatile.

¹⁰⁷ Both “value” managers, which typically buy equities based on the belief that they are undervalued, and socially responsible investment strategies have lower levels of turnover.

¹⁰⁸ A practice which can have a negative effect on engagement is stock-lending, where the institutional investors’ shares are sold subject to a buyback right. According to a survey of RMA more than 1,1 trillion euro of European stocks are available for lending. This can be an obvious barrier for engagement and exercising shareholder rights. Often the stock lending programme appears to be under the control of the asset manager. In order to engage efficiently, both asset owners and managers should have insight into which stocks are subject to lending and who can recall a lend stock. See also International Corporate Governance Network, *Model contract terms between asset owners and their fund managers*.

¹⁰⁹ See for more details annex XII.

¹¹⁰ Article 19 MIFID

¹¹¹ Discretionary mandates, where the assets of an asset owner are not pooled together with assets of others establish a direct contractual link between the asset owner and the asset manager to set strategies and influence and monitor the behavior of the asset manager.

¹¹² Article 21 UCITS implementing Directive 2010/43 and Article 37 AIFM Directive.

¹¹³ Article 33 of MIFID implementing Directive 2006/73; Article 23 of the AIFM Directive and Article 5 of the UCITS Directive.

investors and asset managers showed that 35% has an engagement policy which is disclosed by only 24%, whereas only 16% disclose the outcome of such policies.¹¹⁴

As regards potential solutions to these problems the 2010 and 2011 Green papers as well as the Green paper on long-term financing of the European economy asked a number of questions. In the context of the 2010 Green Paper disclosure of institutional investors' voting practices and policies received strong support from stakeholders. A clear majority of Member States responding supported EU action on this issue¹¹⁵, while some Member States were against EU action.¹¹⁶ Stakeholders considered that such disclosure would raise awareness of investors, optimise investment decision of ultimate investors and facilitate engagement between shareholders and listed companies.

In the context of the 2011 Green Paper the majority of shareholders and institutional investors supported a more effective monitoring of asset managers by institutional investors, particularly with regard to strategies, costs, trading, and the extent to which asset managers engage with the investee companies. However, they expressed themselves mostly in favour of transparency and the diffusion of best practices (but not binding regulation). Companies were also slightly in favour. Asset managers strongly opposed such measures claiming that these aspects are already covered by contractual agreement (mandates) and therefore there is no further need of intervention. Finally, the majority of Member States supported non-binding rule¹¹⁷ while those opposing an action mostly justified their view affirming that mandates should regulate this aspect.¹¹⁸

In the context of the Green paper on the long-term financing of the European economy asset owners, asset managers and companies seemed to agree that the interaction between asset owners and asset managers is key to the promotion of shareholder engagement and that current practice reinforce their short-term focus. EuropeanIssuers¹¹⁹ considers that capital markets do not reward fundamental analysis sufficiently; instead, it is easier to make money from trading activities which do not require analysis of underlying economic realities. Thus market incentives reward traders rather than investors.¹²⁰ EFAMA¹²¹ agrees that there are a number of practices that are currently common in the relation asset owner/manager interaction that reinforce a focus on the short term. These practices include the review of performance on a quarterly basis and the reporting of performance drivers on a quarterly basis. The almost continuous focus on short term movements by asset owners and their advisers lead asset managers to hold companies to account over more short term periods. PensionsEurope¹²² considers that "no incentives should be given within the equity investment chain to drive short-term behaviour" and that pension funds should monitor their manager's investment performance ideally with reference to long-term absolute performance and (...) when assessing investment performance, pension funds should seek to

¹¹⁴ Eurosif, Shareholder Stewardship, European ESG engagement and practices, 2013, page 38. The study covers asset managers and asset owners based in Europe or managing European assets. The study covers 14 markets in detail; Austria, Belgium, Denmark, Finland, France, Germany, Italy, Netherlands, Norway, Poland, Spain, Sweden, Switzerland and the UK. Data were collected from 189 asset owners and asset managers from April to July 2012.

¹¹⁵ Austria, United Kingdom, Germany, Malta, Estonia, Netherlands, Slovakia and Spain.

¹¹⁶ Czech Republic, Finland and Denmark.

¹¹⁷ Spain, Finland, United Kingdom, Estonia, Portugal, Latvia, France.

¹¹⁸ Netherlands, Sweden, Lithuania Germany, Czech Republic and Denmark.

¹¹⁹ Association of European listed companies.

¹²⁰ European Issuers contribution to the consultation on long-term financing of the European economy, page 28.

¹²¹ European Fund and Asset Management Association reply of to the consultation on long-term financing of the European economy.

¹²² Association of European pension funds.

discuss performance with reference to the previously agreed upon investment strategy and not feel pressured to respond to what may be short-term market fluctuations.¹²³ Insurance Europe is of the view that "long-term commitment in investment strategies is key in delivering performance and beneficial to investors and the economy as a whole" and that long-term performance measures and high watermarks should be used by asset owners when defining asset manager mandates.¹²⁴

The consultation on long-term financing of the European economy asked stakeholders what kind of incentives could help promote better long-term shareholder engagement. It also asked how the mandates and incentives given to asset managers can be developed to support long-term investment strategies and relationships and whether there is a need to revisit the definition of fiduciary duty in the context of long-term financing.¹²⁵ Stakeholders strongly supported encouraging better alignment of interests in the equity investment chain, and many stakeholders are in favour of more transparency about portfolio turnover and costs and how asset owners and managers take the long-term interests of their beneficiaries into account and many of them support longer-horizon performance review.

It should be noted however that long-term investors are also interested in short-term profits, also to meet their liquidity needs. Furthermore, selling shares and consequent price declines may also exert a certain pressure on managers for self-discipline to regain credibility. The problem, from a corporate governance point of view, arises when there is a significant shift towards interest primarily in short term value, as demonstrated by portfolio turnover data of long-term investors, crowding out longer-term relationships and engagement. Furthermore, long-term asset owners recognize the importance of and the opportunity in long-term investing.¹²⁶ The growing importance of ESG investors shows that more and more asset owners and managers look at a broader range of longer-term risk factors, including governance, when assessing the overall risk of their portfolio and engage with investee companies to improve their governance and performance. More shareholder engagement is likely to bring benefits for the shareholders and investee companies alike (see under chapter 4.7 and 9).

4.3. Insufficient link between pay and performance of directors

Remuneration of directors has been a constant theme for policy makers, academics¹²⁷ and the media for a number of years. Shareholders may agree with a high pay to directors when they perform very well and when they get value for their investment. However, such pay to directors who are perceived as having underperformed has attracted much criticism from shareholders and, also, from civil society which cannot, especially in times of financial crisis and unemployment, understand the justification for such pay.

This problem occurs because of the principal-agent relation between shareholders and directors which leaves room for directors to act more in their own self-interest than in the interest of the shareholders. Directors' remuneration plays a key role in aligning the interests of directors and shareholders and ensuring that the directors act in the best interest of the company. Where

¹²³ PensionsEurope's contribution to the consultation on long-term financing of the European economy, page 14.

¹²⁴ Insurance Europe's contribution to the consultation on long-term financing of the European economy, page 14.

¹²⁵ See for an overview of the replies Annex XIII.

¹²⁶ See for example reference to Insurance Europe's view above.

¹²⁷ E.g. Berle and Means (1932), Jensen and Meckling (1976), O'Reilly et al (1988), Garen (1994), Murphy (1999), Oxelheim and Randoy (2005).

shareholders do not oversee directors' pay, there is an important risk that directors will apply a strategy which rewards them personally, but that may not contribute to the long-term value of the company. Therefore, lack of oversight may lead to unjustified transfers of value from companies and their shareholders to directors.

The existence of this problem is shown by recent data which demonstrate that there is often an insufficient link between pay and performance. In France¹²⁸ and Austria¹²⁹, where shareholders do not have a say on directors' pay, the average remuneration of directors in the years 2006 to 2012 increased with respectively 94% and 27%, although the average share prices of listed companies in these countries decreased with respectively 34% and 46%. Moreover, recent scandals show the award of generous pay packages with no obvious link to performance. For instance, the WPP advertising company paid £13 million to the CEO in 2011 and £17 million in 2012 although shareholders considered this package not proportionate to performance.¹³⁰ Before that, at the French company Vivendi, a € 21 million severance package gave rise to public criticism.¹³¹ More recently, the golden handshake of the CEO of Nokia caused furore.¹³²

Consultations and academic studies¹³³ show that regulation of directors' pay, and in particular its relationship with performance¹³⁴, is a key concern for shareholders and that significant improvements could be made. Stakeholders argue that it is often difficult to identify the important information amongst all kind of detailed information in the current directors' remuneration reports. The complexity of directors' pay makes it hard to disentangle what executives are

¹²⁸ For comparative data in France, see notably:
ftp://ftp.cemfi.es/pdf/papers/Seminar/InternationalCEOPay_18Nov2008_final.pdf;
<http://lexpansion.lexpress.fr/entreprise/la-remuneration-des-patrons-du-cac-a-augmente-de-34-en-2010-282794.html#IVGcvHTIS3xmYYOv.99>;
<http://www.europoxy.com/divers/ECGS%20report%20on%20Directors%20pay2012.pdf>.

¹²⁹ For comparative data in Austria, see notably: <http://wiev1.orf.at/stories/195502>;
http://media.arbeiterkammer.at/PDF/Vorstandsgehaelter_ATX_Unternehmen_2010-2012.pdf;
ftp://ftp.cemfi.es/pdf/papers/Seminar/InternationalCEOPay_18Nov2008_final.pdf.

¹³⁰ See <http://online.wsj.com/article/SB10001424052702303822204577464264063241178.html>. The following year the CEOs pay was significantly cut and approved by shareholders in an advisory vote. See <http://www.adweek.com/news/advertising-branding/wpp-shareholders-approve-ceo-sorrells-compensation-150228>.

¹³¹ See <http://www.ft.com/cms/s/0/8676422ad7b4-11db-b218-000b5df10621.html> ("Trichet calls for executive pay restraint"), <http://cache.ft.com/cms/s/0/f17f27ee-945f-11dd-953e-000077b07658.html> ("Paris warns on executive pay"), http://www.ft.com/cms/s/d285337a-0ce1-11dd-86df-0000779fd2ac.dwp_uuid=ebe33f66-57aa-11dc-8c65-0000779fd2ac.print=yes.html ("BP shareholders criticise executive pay packages"), <http://www.ft.com/cms/s/0/f3506d4a-b588-11dd-ab71-0000779fd18c.html> ("Pressure mounts on executives to renounce incentives"), <http://www.ft.com/cms/s/2/712f3d9c-5245-11dd-9ba7-000077b07658.html> ("The Lex Overpaid CEO Award"), <http://www.ft.com/cms/s/0/b7c7ceb8-9be2-11dd-ae76-000077b07658.html> ("High pay fails to boost performance, says report").

¹³² http://yle.fi/uutiset/new_nokia_twist_-_elops_contract_revised_same_day_as_microsoft_deal/6847697.

¹³³ For example, Ferrani and Moloney (2005) find that "disclosure requirements prompt the board to justify pay choices and the pay setting process, and can also enhance the accountability and visibility of the remuneration committee". The authors also note that since "setting executive pay is a complex process, opaque disclosure will not generate effective shareholder oversight. In particular, aggregate disclosure concerning total firm executive pay which does not explain remuneration policy and the often highly complex performance conditions applicable (...) will not allow shareholders to assess pay policy effectively".

¹³⁴ As demonstrated by the European Company Law Experts group in 2011, in the absence of binding rules, firms appear reluctant to provide full disclosure concerning remuneration, particularly on the pay/performance link: "It is not possible to compare with any degree of ease how Europe's listed companies address executive pay and, in particular, their approach to performance conditions." available at: <http://europeancompanylawexperts.wordpress.com/papers-of-the-eclle/the-eu-corporate-governance-framework-respons-to-the-european-commissions-green-paper-july-2011/>, page 10.

actually earning and for shareholders to judge whether this is appropriate.¹³⁵ Moreover, the quality of disclosure is insufficient since information on the fixed and variable component of the remuneration policy, and in particular the link between pay and performance, continues to be one of the least published pieces of information by companies.¹³⁶ This makes it time consuming, if not impossible, and costly to assess remuneration and to compare between companies, especially across borders. Moreover, academic studies and factual evidence suggest that the proportion of long-term incentives¹³⁷ in the variable pay of directors is quite low¹³⁸, and that the performance criteria adopted in relation to variable pay (and the time horizon)¹³⁹ are often insufficiently aligned with the longer term interests of the company.

However, at the EU level, there are currently no binding rules on director's remuneration in listed companies, except for the requirement for companies to report, in the annual accounts, on the amount of emoluments paid to members of the administrative, managerial and supervisory bodies.¹⁴⁰ The Commission adopted three Recommendations on directors' remuneration.¹⁴¹ The main recommendations are disclosure of remuneration policy, the individual remuneration of executive and non-executive directors, and a shareholder vote on the remuneration. However, Commission reports¹⁴² and further analysis by the Commission show that the application of these main recommendations by Member States is not satisfactory, since only 6 Member States have fully implemented these main principles. As a result, in Europe, shareholders currently often face difficulties to be properly informed and to exercise control over directors' pay.

By comparison, in the United States, federal legislation requires a high level of disclosure of executive remuneration, with comprehensive disclosure in 12 tables amongst which the ratio CEO salary/mean salary information.¹⁴³ In addition listed companies must submit remuneration policies of some of their directors (including the CEO and CFO) to an advisory vote by the general meeting at least every three years. In Switzerland, a recent referendum introduced a

¹³⁵ See, for example, "Swimming in Words" Deloitte survey of narrative reporting in annual reports (October 2010) and "A Snapshot of FTSE 350 reporting" PwC (2009).

¹³⁶ See G. Ferrarini, M.C. Ungureanu, "Fixing Directors' Remuneration in Europe Governance, Regulation and Disclosure", 2009, available at: http://ec.europa.eu/internal_market/company/docs/directors-remun/roundtable_ferrarini_en.pdf. See also a study conducted by PwC in 2010, on remuneration reports of FTSE150 companies, which found that only around a third clearly disclosed how remuneration is dependent on performance (PwC, "Insight or fatigue? FTSE350 reporting", http://www.pwcwebcast.co.uk/cr_ftse350.pdf). More recently, see the "5ème rapport sur le code AFEP/MEDEF", October 2013, page 46, which shows that only 59% of French listed companies provide information on the application of performance criteria.

¹³⁷ Long-term incentive plans involve the granting of shares to directors after (at least) three year period upon the achievement of performance criteria, and must include some qualifying conditions with respect to service or performance that cannot be fulfilled within a single financial year.

¹³⁸ While in 2006 the total CEO's pay was composed of 43% of long-term incentives, in 2012 the total CEO's pay is composed of 25% of long-term incentives (for the year 2006, see notably: ftp://ftp.cemfi.es/pdf/papers/Seminar/InternationalCEOPay_18Nov2008_final.pdf; for the year 2012, see notably: <http://www.europaproxy.com/divers/ECGS%20report%20on%20Directors%20pay2012.pdf>),

¹³⁹ A study showed that missing quarterly earnings benchmarks are associated with higher risks of being fired and getting lower bonuses and lower equity based compensation. See <http://www.hbs.edu/research/pdf/09-014.pdf>.

¹⁴⁰ See Article 17(1) (d) of the Accounting Directive 2013/34/EU. The Directive allows however Member States not to apply this requirements when the information makes it possible to identify the position of a specific member of such a body.

¹⁴¹ Commission Recommendations 2004/913/EC, 2005/162/EC and 2009/385/EC.

¹⁴² Report on the application by Member States of the EU of the Commission Recommendation on directors' remuneration (SEC 2007, 1022) and Report on the application by Member States of the EU of the Commission 2009/385/EC Recommendation complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies SEC(2010)285.

¹⁴³ See <http://www.sec.gov/rules/final/2006/33-8732afr.pdf>

shareholder vote on the global amount of remuneration and banned the golden parachutes and other termination payments.¹⁴⁴

Indeed, in many Member States, shareholders do not have sufficient information on directors' remuneration since the information disclosed by companies is not comprehensive, clear nor comparable. 15 Member States¹⁴⁵ require disclosure of the remuneration policy and only 11 Member States¹⁴⁶ require disclosure of individual directors' pay. Four Member States have published templates that companies should use to disclose directors' remuneration.¹⁴⁷ According to available data from 19 Member States, only around a third of the listed companies disclose how remuneration is dependent on performance.¹⁴⁸ Even in the other Member States, the situation is problematic: in the Netherlands for instance, under the relevant corporate governance code provisions, compliance with the obligation to describe the relation between pay and performance is one of the least applied provisions with an application of 64%; moreover, there was almost never an explication for non-compliance.¹⁴⁹ The Dutch corporate governance monitoring committee in this respect also noted in 2013 that in general pay structures and remuneration policy are not simple and transparent and that the committee has not been able to bring any improvements in this area.¹⁵⁰

Furthermore, in many Member States, shareholders often do not have sufficient tools to express their opinion on directors' remuneration which in their view is not appropriate or not justified by performance. Indeed, only 13 Member States give shareholders a say on pay through either a vote on directors' remuneration policy and/or report.¹⁵¹ 10 Member States have introduced a binding shareholder vote¹⁵² and three an advisory one.¹⁵³ Moreover, the Member States approaches are very diverse. For example, in France, there is currently no legislative requirement to have a vote on the remuneration policy, report or on individual remuneration, but shareholders have a right to vote on certain specific issues linked to remuneration.¹⁵⁴

The experience of Member States shows the positive impact of "say on pay" on creating a link between directors' remuneration and companies' performance.¹⁵⁵ In Italy¹⁵⁶ and Spain¹⁵⁷, before

¹⁴⁴ For the text, see <http://www.admin.ch/ch/f/pore/vi/vis348t.html> (in French).

¹⁴⁵ Member States requiring disclosure of the remuneration policy are Austria, Belgium, Bulgaria, Czech Republic, France, Germany, Italy, Latvia, Lithuania, Netherlands, Portugal, Slovakia, Spain, Sweden and United Kingdom.

¹⁴⁶ Member States requiring disclosure of individual director pay are Austria, Belgium, France, Germany, Italy, Lithuania, Netherlands, Portugal, Spain, Sweden and United Kingdom.

¹⁴⁷ These Member States are Belgium, France, Italy and Spain. Some other Member States (Lithuania, Netherlands, Portugal, Slovakia and United Kingdom) haven't published such template, but impose minimum information requirements.

¹⁴⁸ These member States are Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Germany, Greece, Hungary, Ireland, Lithuania, Luxembourg, Malta, Poland, Romania, Slovenia and United Kingdom. See also PwC, *Insight or fatigue? FTSE350 reporting, 2010*. Available at: http://www.pwcwebcast.co.uk/cr_ftse350.pdf

¹⁴⁹ See Dutch Monitoring Committee of the Corporate Governance Code, Fourth report on compliance with the Dutch corporate governance code. page 18.

¹⁵⁰ Report of 1 October 2013, page 21. See <https://docs.google.com/viewer?url=http://www.mccg.nl/download/?id%3D2199>.

¹⁵¹ For more details regarding the situation in Member States, see Annex VI.

¹⁵² Belgium, Bulgaria, Denmark, Hungary, Latvia, Netherlands, Portugal, Slovakia, Sweden and the United Kingdom.

¹⁵³ Czech Republic, Italy and Spain.

¹⁵⁴ See in particular, articles L.225-42-1, L.225-45 al.1, L.225-90-1, L.225-185 al.4 and L.225-197-II of the Code de commerce.

¹⁵⁵ Measured in the development of the share price.

¹⁵⁶ For comparative data in Italy, see notably:

the introduction of an advisory say on pay in 2011, the average share price in the years 2006 to 2011 went down with respectively 130% and 40%, while the average remuneration of directors of listed companies increased by respectively 29% and 26%. However, since the law has been adopted in 2011, the average share price of listed companies has respectively increased by 10% and decreased by 5%, but the remuneration of directors has also increased by 1% and declined by 10%. There may be several reasons for this development, but this correlation has also been demonstrated by academic studies that showed in 2004 that the implementation of the regulation introducing an advisory say on pay in the United Kingdom has resulted in reduction of CEO remuneration in case of poor performance.¹⁵⁸

Such link between pay and performance is even stronger in Member States where shareholders have been granted a binding say on pay. In Sweden¹⁵⁹ and Belgium¹⁶⁰, before the adoption of a binding say on pay in respectively 2010 and 2011, the average share price from 2006 to 2009 and from 2006 to 2011 went down respectively with 17% and 45%, while average pay of directors of listed companies increased respectively with 18% and 95%. However, since the laws were adopted in respectively 2010 and 2011, the share price has respectively increased by 16% and 18% but the remuneration of directors has also increased with 18% and decreased (as a correction) by 10%. Academic studies also show that the introduction of a binding say on pay in the Netherlands in 2007 has resulted in a closer link between shareholder value and remuneration and in greater levels of engagement between companies and shareholders.¹⁶¹

4.4. Lack of shareholder oversight on related party transactions

One of the most commonly heard complaints about corporate behaviour concerns related party transactions (RPTs): transactions between a company and its management, directors, controlling

http://www.borsaitaliana.it/borsaitaliana/statistiche/statistiche-storiche/principaliindicatori/2013/principaliindicatori2013_pdf.htm;
<http://www.frontisgovernance.com/attachments/article/69/Frontis%20Governance%20-%20CG%20Rating%20Report%20SAMPLE.pdf>;
<http://www.ilsole24ore.com/art/economia/2011-07-27/stipendio-piatto-064456.shtml?uuid=Aag1XcrD>.

¹⁵⁷ For comparative data in Spain, see notably:http://www.cnmv.es/DocPortal/Publicaciones/Informes/IAGC_IBEX35_2011.pdf; http://www.cnmv.es/DocPortal/Publicaciones/Informes/IAGC_IBEX35_2012.pdf.

¹⁵⁸ In 2004, a study made by Deloitte has shown that the introduction of say on pay has resulted in a reduction of severance payments mentioned in the contracts of CEOs and the introduction of procedures for reassessment of performance in case of non-achievement of targets (Deloitte, « Report on the impact of the directors' remuneration report regulation », 2004). In 2008, a study highlights that, after the introduction of say on pay, the sensitivity of pay to stock and operating performance has increased, especially in case of bad performance (F. Ferri et D. Marber, « Say on pay vote and CEO compensation : evidence from UK », mimeo, Harvard Business School, 2008). These two studies therefore provide consistent results: the establishment of a procedure for "say on pay" reduces CEO compensation in case of poor performance and therefore increases the sensitivity of pay to performance in areas of poor performance.

¹⁵⁹ For comparative data in Sweden, see notably:
http://www.haygroup.com/downloads/ww/HG280_Say%20on%20Pay_v05.pdf; <http://www.thelocal.se/31884/20110207/>;
https://gupea.ub.gu.se/bitstream/2077/33338/1/gupea_2077_33338_1.pdf.

¹⁶⁰ For comparative data in Belgium, see notably:
ftp://ftp.cemfi.es/pdf/papers/Seminar/InternationalCEOPay_18Nov2008_final.pdf;
http://www.haygroup.com/downloads/ww/HG280_Say%20on%20Pay_v05.pdf;
<http://www.7sur7.be/7s7/fr/2402/Crise-boursiere/article/detail/1606189/2013/03/30/Les-patrons-du-Bel20-ont-du-se-serrer-la-ceinture.dhtml>.

¹⁶¹ See study by Groningen University conducted on behalf of the Dutch Corporate Governance Code Monitoring Committee in 2007.

entities or shareholders.¹⁶² An example of such a transaction is a contract between a company and its chief executive officer under which the former sells a 100% subsidiary to the latter. Generally, the approach is not to forbid such transactions, since they can be productive and create value, but to regulate them.¹⁶³

The EU legislative framework requires companies to include in their annual accounts a note on material transactions entered into with related parties that are not concluded under normal market conditions, stating the amount and the nature of the transaction and other necessary information.¹⁶⁴ The Transparency Directive 2004/109/EC¹⁶⁵ and the implementing Directive 2007/14/EC¹⁶⁶ contain some further transparency obligations for listed companies. This framework provides some harmonisation of the rules on RPTs, focused on *ex post* disclosure.¹⁶⁷ There are however no EU rules that provide for public disclosure at the time of the conclusion of the RPT, nor for involvement of shareholders.

Member States have regulated RPTs in very different manners. Some Member States have solely taken over the EU Accounting provisions in this area¹⁶⁸, others have created more detailed transparency rules with specific thresholds or specific procedural obligations¹⁶⁹, while many Member States give the (supervisory) board a specific role whereas directors with whom a transaction would be concluded are sometimes excluded from voting.¹⁷⁰ In addition, in some Member States independent advisors have been given a role¹⁷¹ and in a number of Member States shareholders have to approve RPTs.¹⁷² Finally, a number of Member States also forbid certain specific RPTs.¹⁷³ However, even where Member States follow in essence the same approach, the details of their rules are very often quite different¹⁷⁴, which makes it difficult, time consuming and costly for foreign investors to try to influence decisions on important RPTs.

EU companies report a high level of RPTs. In Spain 78% of listed companies reported a significant RPT¹⁷⁵ in the last three years; in Ireland 47%; in Austria 22%; in France 15%; in Poland 14%; in Italy 8%; in Germany 7%; in the UK 5,5% and in the Netherlands 0%.¹⁷⁶ The three Member States with the highest percentage of reported RPT do not foresee an obligatory fairness opinion for the largest RPT, nor a shareholder vote. 35 % out of a sample of 54 listed

¹⁶² See OECD, *Related Party Transactions and Minority Shareholder Rights*, 2012, page 20.

¹⁶³ Ibidem.

¹⁶⁴ See Article 43(1) (7b) of Directive 78/660/EEC and Article 34(7b) of Directive 83/349/EEC.

¹⁶⁵ See Article 5 (4).

¹⁶⁶ See Article 4.

¹⁶⁷ Certain important aspects of disclosure of related party transactions have also been defined in the International Accounting Standard no 24 on Related Party Disclosures, endorsed by European Union by virtue of the Commission Regulation (EC) No 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council. International Accounting Standard 24 defines what is a related party. See <http://www.iasplus.com/en/standards/ias24>.

¹⁶⁸ For instance Denmark, Hungary and Poland.

¹⁶⁹ For instance in Belgium, Finland, Germany, Italy, Sweden and France.

¹⁷⁰ For instance The Netherlands, Finland, Belgium, Spain, Portugal and France.

¹⁷¹ For instance in the UK, Belgium, Germany, Latvia, Sweden and in some cases in the Czech Republic. In Spain the supervisory authority can request an independent advisor to provide advice.

¹⁷² For instance in the United Kingdom, France, Sweden, Bulgaria and Greece. For some transactions in a group context shareholder approval is also required in Germany and the Czech Republic.

¹⁷³ For instance Portugal, the Netherlands, Greece.

¹⁷⁴ An overview of rules on related party transactions in Member States is provided in the LSE *Study on Directors Duties and Liabilities*, section 2.5.2, http://ec.europa.eu/internal_market/company/board/index_en.htm.

¹⁷⁵ Defined as above 1% of revenue or more.

¹⁷⁶ See OECD, *Related Party Transactions and Minority Shareholder Rights*, 2012, page 31.

companies in Germany reported significant RPTs in the year 2011.¹⁷⁷ In a sample of 85 companies listed on the Paris stock exchange 80 % reported RPTs. In total, the latter reported 1.186 RPTs over a period of three years. 30 % of these companies reported ten or more transactions. 371 of the RPTs were considered likely to lead to unjustified transfer of value to related parties.¹⁷⁸ It should be noted that under EU law companies are only obliged to report those transactions that are not concluded on market terms, and therefore could entail unjustified transfers of value to the related party.¹⁷⁹

In the OECD's Peer review on RPTs a number of Member State systems were assessed. For Belgium, the OECD report considered that a more direct role for shareholders in approving key transactions might be considered as well as greater formalisation of the law.¹⁸⁰ In France the existing rules are actively debated and the streamlining of the rules and an improvement of the information to the market are advocated.¹⁸¹ Moreover, the French *Autorité du Marché Financier* has recommended the nomination of an independent expert and a shareholder vote in case of a significant RPTs.¹⁸² Finally, studies show that RPTs can have a negative impact on the value of the company¹⁸³, since they transfer value from the company and its minority shareholder to those who control the company, the directors and/or the companies affiliated with them.¹⁸⁴

The high level of reporting of RPTs concluded on non-market terms does not mean that all reported transactions entail unjustified transfers of value. However, it does mean, certainly in view of the opinions of stakeholders, that there is an EU corporate governance issue as far as minority shareholder protection is concerned. A significant majority of the shareholders and asset managers and a small majority of institutional investors that responded to the 2011 Green Paper are in favour of EU action to ensure more procedural protection against RPTs. All of them support an increase in transparency. Most responding shareholders and asset managers, supported by the views of several institutional investors, explicitly call for shareholders' approval of significant related party transaction, excluding the interested party. On the other hand a majority of responding companies oppose EU actions on related party transactions, since national measures would in their view be sufficient. A majority of Member States that replied to this question advocate however an EU wide disclosure regime that would make related party transactions more transparent¹⁸⁵, while a large minority of Member States¹⁸⁶ supports an EU action giving shareholders a vote. The existing rules do not provide minority shareholders, amongst which asset owners and managers with large portfolios of foreign shares with the

¹⁷⁷ I. Von Keitz, Th. Gloth, Praxis ausgewählter HGB/Anhangangaben (Teil 2) – eine empirische Analyse von 54 Jahresabschlüssen, in: Der Betrieb (1.2.2013), p. 190.

¹⁷⁸ M. Nekhili, M. Cherif, Related parties transactions and firm's market value. The French case, in: Review of Accounting and Finance, Vol. 10 No. 3 (2011), p. 303.

¹⁷⁹ Companies may however decide to report all significant related party transactions. On the other hand in view of the relative flexibility of the legal framework ("material", "non-market terms") companies may also underreport RPTs. See OECD, *Related Party Transactions and Minority Shareholder Rights*, 2012, page 21. Under Article 17 (1) r of the new Accounting Directive 2013/34/EC Member States may permit or require that only transactions with related parties that have not been concluded under normal market conditions be disclosed.

¹⁸⁰ See OECD, *Related Party Transactions and Minority Shareholder Rights*, 2012, page 58.

¹⁸¹ See OECD, *Related Party Transactions and Minority Shareholder Rights*, 2012, page 62-63.

¹⁸² See Recommendation of the AMF n° 2012-05, Les assemblées générales d'actionnaires de sociétés cotées, proposition 25 and 32.

¹⁸³ Measured by Tobin's Q, this effect is -2.165, according to Nekhili and Cherif, Related parties transactions and firm's market value. The French case, p. 302. This shows a significant negative impact (both economically and statistically) of related party transactions on firm valuations".

¹⁸⁴ Nekhili, Cherif, Related parties transactions and firm's market value. The French case, p. 306.

¹⁸⁵ Sweden, Denmark, Finland, Germany, Czech Republic, Netherlands, France.

¹⁸⁶ Spain, Lithuania, United Kingdom, Estonia, Portugal, Latvia.

necessary information and proportionate and cost-effective tools to assess and defend themselves against RPTs.

4.5. Doubts on the reliability of the advice of proxy advisors

Many institutional investors and asset managers use the services of proxy advisors who provide recommendations how to vote in general meetings of listed companies. The number of (cross-border) holdings by many institutional investors and asset managers and the complexity of the issues to be considered make the use of proxy advisors in many cases inevitable. One important benefit for investors is that these specialised advisors help reduce costs of the analysis of the information on companies.

Proxy advisors are not subject to any regulation at EU level. Non-binding rules exist only in few Member States. For example, the French Autorité du Marché Financier (AMF) recommendation on proxy advisors promotes transparency in the establishment and execution of voting policies by proxy advisors and recommends establishing appropriate rules on the management of conflicts of interest.¹⁸⁷ In the UK, the Financial Reporting Council's Stewardship Code also applies to proxy advisors.¹⁸⁸

Although in many cases institutional investors and asset managers vote on the basis of various sources of data, proxy advisors have an important influence on voting behaviour of investors¹⁸⁹, which makes them, to some extent, a standard setter in the area of corporate governance.¹⁹⁰ In particular, investors with highly diversified portfolios and many foreign holdings of shares rely more on proxy recommendations.¹⁹¹ During a recent consultation by ESMA¹⁹², "most respondents acknowledged there is a high correlation between voting outcomes and proxy advices". The impact of proxy advisory firms' recommendations is reinforced by the characteristics of this sector¹⁹³, in which there is currently limited competition: only two proxy advisors are able to meet the (European) needs of internationally operating investors.¹⁹⁴ In the

¹⁸⁷ AMF Recommendation No. 2011-06 of 18 March 2011 on proxy advisory firms (EN version), at: http://www.amf-france.org/documents/general/9915_1.pdf

¹⁸⁸ The UK Stewardship Code, at: <http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-September-2012.aspx>

¹⁸⁹ Research literature demonstrates that a negative recommendation from the proxy advisor Institutional Shareholder Services (ISS) can influence 19% of the votes, see Jie Cai, Jacqueline L. Garner, Ralph A. Walkling, Electing Directors, *The Journal of Finance*, Vol. 64, Issue 5, pp. 2389–2421, October 2009. See also S. Choi, J. Fisch and M. Kahan, The power of proxy advisors; myth or reality?, *Emory Law Journal*, Vol. 59, p. 869, estimating that ISS recommendation shifts 6-10% of shareholder votes. See also D. Larcker, Allan McCally, G.Ormazabal Outsourcing Shareholder Voting to Proxy Advisory Firms, May 2013.

¹⁹⁰ Foreign asset managers active in the Netherlands mentioned the ISS voting behaviour guidelines the most often as the most important guidelines for corporate governance. See Dutch Monitoring Committee of the Corporate Governance Code, Third report on compliance with the Dutch corporate governance code, 2012, page 43.

In the United States, "about 70% of 110 large and midsize companies said their executive-pay practices are influenced by proxy-advisory firms, according to a 2012 study co-led by the Conference Board, a New York research group"- The Wall Street Journal- 22 may 2013.

¹⁹¹ See M. C. Schouten, Do institutional investors follow proxy advice blindly? 2012, available at <http://ssrn.com/abstract=1978343>.

¹⁹² See ESMA Final Report, Feedback Statement on the consultation regarding the role of the proxy advisory industry, 19 February 2013, page 12.

¹⁹³ According to ESMA analysis, there are currently less than 10 players active in the EU, two of which are international players from the US, ISS and Glass Lewis, and a number of local participants in Europe, with mostly a domestic focus, such as Manifest in the UK, Ivox in Germany or Proxinvest in France.

¹⁹⁴ See Lars Klöhn, Philip Schwarz, The regulation of proxy advisors, December 2012, page 2-18. These authors note that ISS issues recommendations for more than 40 000 shareholders meetings from more than

Netherlands the Dutch Corporate governance code Monitoring Committee noted that of the Dutch and foreign institutional investors that took part in a survey 56% indicated that they made use of proxy advisors. Of the asset managers 100% made use of them. 83% of these two groups made use of one the two biggest proxy advisors, ISS and Glass Lewis. They only very slightly deviate from the advice given.¹⁹⁵ According to the underlying study the influence of the proxy advice is, on a scale of 10, 5.5 for Dutch companies, but 7,8 for foreign listed companies. Institutional investors and asset managers estimate that the degree of checking the advice is 8.3 for Dutch companies and only 3.4 for foreign listed companies.¹⁹⁶ According to an OECD study the German government stated that 80% of the foreign institutional investors follow the advice of proxy advisors.¹⁹⁷ In other words, especially for cross-border shareholdings the influence of proxy advisors is very significant, to a large extent uncontrolled by their users and issuers and, in view of the existing lack of transparency, uncontrollable. The 2012 survey conducted by the Dutch Monitoring Committee of the Corporate Governance Code states that investors in companies with widespread shareholdings in particular, especially foreign investors tend to be guided by proxy advisors on the basis of "foreign best practices" that cannot be considered in all cases as being generally accepted best practices.

Proxy advisors' relations with issuers may also give rise to concerns. The different services provided to issuers, such as governance consultancy, may affect the independence of the proxy advisor and their ability to provide an objective and reliable advice. As proxy advisors are subject to conflicts of interests¹⁹⁸, appropriate procedures for the prevention, detection and treatment of such conflicts are necessary.

In view of the important role of the recommendations of proxy advisors these should be accurate and reliable. However, stakeholders noted shortcomings concerning the quality of advice, such as for example advice not taking account of certain key features of the national corporate governance framework, as well as situations of conflict of interests, for example when proxy advisors also provide services to companies.¹⁹⁹ A majority of respondents to the 2011 Green Paper considered that the level of transparency of proxy advisors was not sufficient, which made the evaluation of accuracy and reliability of the work of proxy advisors difficult. There was a strong support from shareholders, institutional investors and asset managers to increase the transparency of the methodology used and for addressing the conflict of interest problem. Companies also called for regulation of the sector, mainly justifying it by pointing to the risk that could arise from the influence proxy advisors currently have. Furthermore, all proxy advisors that answered to the consultation affirm to be in favour of more transparency and the diffusion of a code of conduct.²⁰⁰ Finally, the majority of the Member States that expressed their views were in favour of increasing the transparency of the methodology used and addressing the conflict of interest,²⁰¹ while only few saw it was unnecessary.²⁰²

100 countries and Glass Lewis for more than 23 000 shareholders meetings of companies from more than 100 countries.

¹⁹⁵ See <https://docs.google.com/viewer?url=http://www.mccg.nl/download/?id%3D579>, page 56-57.

¹⁹⁶ Nyenrode Business Universiteit, Aandeelhoudersbetrokkenheid in Nederland. Onderzoek onder institutionele beleggers en hun relatie met Nederlandse beursfondsen, 2010, see <http://commissiecorporategovernance.nl/rapport-2010>

¹⁹⁷ See OECD, The Role of Institutional investors in promoting Good Corporate Governance, page 121.

¹⁹⁸ Because of the large number of clients, the financial relations they may have or the varied nature of services they may offer.

¹⁹⁹ On 8 October 2013 the proxy advisor Proxinvest apologized for an incorrect assessment of the situation of Schneider Electric. See <http://www.proxinvest.com/divers/ERRATUM%20Communiqu%C3%A9%20de%20presse%202013.pdf>

²⁰⁰ ISS, Glass Lewis, PIRC, Proxinvest, ECGS and Computershare.

²⁰¹ Spain, Finland, Germany, United Kingdom, Estonia, Portugal, Latvia, Austria and France.

Also the ESMA consultation showed that there is a support for increased transparency on the methodologies used by proxy advisors and on their handling of conflicts of interest.²⁰³ In particular most issuers considered that proxy advisors do not take into account local legal framework and practices, that they do not devote enough resources and that there is a lack of specific knowledge.²⁰⁴ In this respect it is important to note that materials for general meetings are often only available 21 days before the date of this meeting and that most general meetings are clustered around a limited number of months from March to July.²⁰⁵

Where the methodologies used by proxy advisors to make their recommendations do not sufficiently take into account local market and regulatory conditions, the quality and the accuracy of the advice to investors is negatively affected.²⁰⁶ This leads to a one size fits all approach in corporate governance, which negatively affects the corporate governance of listed companies. It is moreover to be noted that the suggested developments on enhanced shareholder rights (on remuneration and related party transactions) will result in an increase of their influence and work for a relatively small sector: the divulgation of methodologies used is a key element to assess the work they perform, both for the issuer which is the object of the recommendation and of the users of this information.

4.6. Obstacles to the exercise of shareholder rights

4.6.1. Identification of shareholders

The Commission's Action Plan envisages to enhance transparency between companies and investors, encourage long-term shareholder engagement²⁰⁷, but intermediated holding chains act as significant obstacles to shareholder engagement.

It is difficult for the company to identify who the shareholder is. Identification of the shareholder is essential to facilitate the exercise of shareholder rights as it is a prerequisite for direct communication between the shareholder and the company. The cooperation between the company and the shareholder is improved when the issuer can directly communicate with them. This strengthens corporate governance, e.g. through the direct casting of votes without the intervention of the chain of intermediaries.²⁰⁸

The identification of the shareholder in a domestic context is difficult in some Member States, e.g. the UK's successful s.793 rule²⁰⁹ may be effective but it is highly intensive and time-consuming. But the cross-border situation is even more cumbersome, particularly where multi-tiered holding chains cross several jurisdictions. The shareholders right to represent himself or to

²⁰² Sweden, Denmark, Lithuania, Czech republic.

²⁰³ See ESMA Feedback Statement, page 1 and 19.

²⁰⁴ See ESMA Feedback Statement, page 16.

²⁰⁵ See article 5 (4) of the Shareholder Rights Directive. On main markets, the annual general meeting season is heavily concentrated. «More than 54% of annual shareholder meetings in the USA were held in April, May or June » (Council of Institutional Investors, 2010). The market leader ISS “covers nearly 35,000 public companies across 115 global markets annually. ISS’ research staff is comprised of more than 200 research analysts and 75 data analysts, located in financial centres worldwide” (ISS 2011 Due diligences compliance package). If each staff member of ISS would only work on preparing voting recommendations, they would have to prepare recommendations for 127 listed companies within a period of some months.

²⁰⁶ See ESMA Feedback Statement, page 16.

²⁰⁷ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2012:0740:FIN:EN:PDF>

²⁰⁸ Capita Registers, *Response to the Green Paper on the EU Corporate Governance Framework*, p. 8, notes that where there is greater visibility of the shareholder basis, there tends to be a higher level of voting.

²⁰⁹ Companies Act 2006 - <http://www.legislation.gov.uk/ukpga/2006/46/section/793>

give instructions can only be realised if the link can be traced in a timely and reliable way. Although market practices vary widely, there are efficient national solutions for local shareholder identification in most markets, but a significant obstacle to cross-border identification is the legal uncertainty among foreign intermediaries as to if they can share their client's data.²¹⁰ This is often brought to the Commission's attention: in public consultations, a number of stakeholders argued for a "shareholder identification principle"²¹¹ and the Reflection Group on the Future of EU Company Law recommended allowing companies to identify their shareholders and directly communicate with them.²¹² This is supported by 81% of issuers and 88% of investors.²¹³

Example: *An intermediary in the Netherlands, where there is no legal framework allowing Dutch company to obtain shareholders identification²¹⁴, may not be aware of the laws of another country, e.g. shares issued under Irish law, that requires shareholder disclosure and in any event may consider that their own local laws (e.g. on banking secrecy) may prohibit such disclosure. In effect, the Irish company has no means to identify its shareholders, even if the Irish law, under which the securities are constituted, gives him the right.*

4.6.2. Cross-border transmission of information by intermediaries, including exercise of shareholder rights

There is wide-spread agreement among stakeholders that significant problems occur in the internal market regarding the cross-border exercise of rights attached to shares.²¹⁵ Investors face difficulties in exercising the rights flowing from their shares, especially if they are held cross-border. Such rights include, e.g. the right to attend meetings and to vote, to get a dividend, to participate in decisions on mergers, takeovers or stock splits and to challenge decisions of a company in court proceedings.

The longer the holding chain and the more intermediaries are involved, the higher the chance that information is not passed to shareholders from companies or that investors' votes get lost. This results in instructions given by shareholders to intermediaries to vote for shares held not always being executed. There is also a greater likelihood of misuse of the voting rights by intermediaries. Companies and shareholders have repeatedly raised these problems in discussions with the Commission and characterise them as recurring.

The exercise of rights from shares requires that shareholders get information and messages from companies on time, e.g. when deciding whether to approve a transaction to which the counterparty is a director, shareholders need to have details of the transaction including the price and the existence of other potential counterparties. Equally, information and messages from the shareholder to the company (e.g. voting instructions) need to reach the company to achieve its objective. There is general agreement among stakeholders that significant problems occur in the internal market regarding the cross-border exercise of rights attached to shares.²¹⁶

Timely transmission of information (e.g. instructions) and rights (e.g. dividends), relies on the intermediaries in a holding chain,. Though dividend payments normally arrive to the investor,

²¹⁰ T2S Taskforce on Shareholder Transparency, Final Report to the T2S Advisory Group, version: 28.2.2011, p. 13.

²¹¹ See footnote 16. 42% of stakeholders saw a need for the EU to help issuers identify their shareholders to facilitate dialogue on corporate governance, 43% respondents did not have a clear view, while 15% were negative.

²¹² *Report of the Reflection Group on the Future of EU Company Law*, 5. 4.2011, p. 50.

²¹³ Public consultation on the EU corporate governance framework, July 2011, http://ec.europa.eu/internal_market/consultations/2011/corporate-governance-framework_en.htm

²¹⁴ *Ibid*, *Market Analysis of Shareholder Transparency Regimes in Europe*, v. 21.2.2011.

²¹⁵ C.f. footnote 16.

²¹⁶ C.f. footnote 16.

disenfranchisement from participation in the company's decision-making is widespread.²¹⁷ This is mainly due to jurisdictional differences in the levels of assistance given by intermediaries to clients and compliance with duties to send information.²¹⁸ So rights flowing from the shares may not be processed properly through the holding chain and the exercise of cross-border shareholder rights may suffer. Intermediaries suffer from the lack of standardisation of messaging from companies. Differing national standards on intermediary duties pose a high legal risk to intermediaries when they process corporate information; if it goes wrong, intermediaries can be exposed to financial risk.

4.6.3. Price discrimination by intermediaries for cross-border transmission of information, including exercise of shareholder rights

The problem of intermediaries who charge higher fees for cross-border transmission of information and the processing of rights was raised in the Commission's 2009 consultation. A large majority of the respondents replying to the question (companies/shareholders as well as intermediaries), considered that there are additional costs related to cross-border situations in case of need for information, as well as when trying to exercise shareholder rights. The size of the difference between domestic and cross-border costs ranged from an "insignificant increase" (from an Irish intermediaries association), through 30% higher for wholesale trades and 150% higher for retail trades (from an International Central Security Depository ("ICSD")), "for General Meetings from 200 to 300% more" (from 18 German listed companies), or "minimum 500% more" (according to UK intermediaries), to as much as a "dozen times more" (from the Polish Central Security Depository ("CSD")).²¹⁹ The scale of price discrimination acts as a deterrent to cross-border investment and the efficient functioning of the Internal Market. In the second public consultation, 20 stakeholders confirmed that they had encountered different prices for cross-border exercise of rights. The following examples were provided: specific fees were required for the registering of shares from France to Belgium (ECGS); a certification of holdings of a security (which is necessary to exercise the rights enshrined in the security) was more expensive if it involved a cross-border aspect (German issuers and investors); the cross-border exercise of voting rights was much more expensive, normally more than ten times, sometimes more than hundred times the cost of a purely domestic voting rights exercise (German issuers and investors). Furthermore, according to ECGS and ESH voting charges can reach up to EUR 150 per voting session. The request for a ballot (voting card) at a French general meeting in Germany may easily be charged with EUR 100 by the deposit bank whereas the request for a ballot at a German general meeting would still be free of charge for the shareholder. In a survey, 27% respondents indicated that they take cost of voting into account in making the decision to vote at a shareholder meeting.²²⁰

Price discrimination creates a barrier to the internal market as an intermediary's services relating to passing on voting instructions become an indirect barrier for shareholders to vote and thus to be engaged. Stakeholders confirmed that they had encountered different prices for the cross-border exercise of rights. Two associations of intermediaries explained that their members applied different pricing models as the costs in the cross-border context were increased due to

²¹⁷ Christian Strenger and Dirk A. Zetzsche, *Corporate Governance, Cross-border voting, and the (draft) Securities Law Directive*, December 2012.

²¹⁸ In the Giovannini Reports 'corporate actions processing' is Barrier 3; "the variety of rules, information requirements and deadlines for corporate actions."

²¹⁹ C.f. footnote 15.

²²⁰ C.f. footnote 16, Questions 36 and 37.

longer chains or different currencies.²²¹ Cross-border investment will continue to be discouraged by unjustifiably higher fees. This has the effect of reinforcing fragmentation and restricting investment to domestic opportunities.

4.7. Insufficient quality of corporate governance information

Article 20 of Directive 2013/34/EU requires listed companies to provide an annual corporate governance statement. This statement should provide essential information on the corporate governance arrangements of the company and in particular include a reference to the corporate governance code applied on a 'comply or explain' basis. Under the 'comply or explain' approach, a company which chooses to depart from a corporate governance code recommendation must give detailed, specific and concrete reasons for the non-application. These explanations require a company to reflect on its corporate governance and are used by investors to make their investment decisions.

The main advantage of this method is its flexibility as it allows companies to adapt their corporate governance to their size, shareholding structure, and sectorial specificities. This approach recognises that, in certain circumstances, non-compliance with certain recommendations might correspond better to the company's interest than 100% compliance with the code. Appropriate disclosure of deviations from the relevant codes and the reasons for this reduces the information asymmetry between the company directors and its shareholders and decreases the monitoring costs. It also confers legitimacy to the company's choice to put in place corporate governance arrangements which are not in line with the code's recommendations.²²²

However, the 'comply or explain' approach is in practice not applied very well by companies. A study on monitoring and enforcement systems for Member States' corporate governance codes²²³ revealed important shortcomings in applying the 'comply or explain' principle. According to the study, the overall quality of companies' corporate governance statements when departing from a corporate governance code recommendation is unsatisfactory. In over 60% of cases where companies chose not to apply certain recommendations, they did not provide sufficient explanation.²²⁴ Although the study dates from 2009 information further analysis by the Commission and discussions with the European Corporate Governance Codes Network²²⁵ on the application of the 'comply or explain' approach in 15 Member States shows that the situation has not improved significantly since then. In its 2012 report the UK Financial Reporting Council noted that "the standard of explanations is variable. Companies are generally better at setting out the background and actions taken to mitigate any governance concerns than they are at explaining

²²¹ C.f. footnote 16.

²²² See J. G. C. M. Galle, *Consensus on the comply or explain principle within the EU corporate governance framework: legal and empirical research*, Kluwer, 2012.

²²³ Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States, 2009, available at http://ec.europa.eu/internal_market/company/ecgforum/studies_en.htm. The main results of the study are summarised in Annex V.

²²⁴ They either simply stated that they had departed from a recommendation without any further explanation, or provided only a general explanation without reference to the company specificity or only a limited explanation (see page 83 of the study). The survey of investor satisfaction performed by the contractor also showed only a limited degree of satisfaction of investors, of which only a quarter considered the explanations provided by companies as satisfactory, see page 155.

²²⁵ See <http://www.ecgcn.org/Home.aspx>

the rationale for their decisions” and that “there were still many examples of generic and boiler-plate reporting”.²²⁶

Concerning the need to increase the quality of the information given by companies departing from the recommendations of corporate governance codes, an overwhelming support was shown by shareholders, asset managers and proxy advisors as well as by institutional investors that unanimously called for the measure. All stakeholders pointed out to the benefits that they could receive from receiving more information from companies. Additionally, also the majority of companies were in favour of more information. They asked for guidelines on what information is needed. The majority of Member States that answered to the question showed clear support for improving the system²²⁷ however they suggested being careful not to increase the cost for companies. Some other Member States²²⁸ support the objective, but believe it should be addressed without imposing new rules. Following on from the 2011 Green Paper, certain Member States, such as Finland, UK and Belgium have initiated discussions or issued guidelines on the quality of the explanations provided by companies.²²⁹ However, such initiatives have only been undertaken in a minority of Member States. Consultations have shown that since then these problems have not been solved.

These deficiencies in the quality of corporate governance reporting make it more difficult for shareholders to take informed investment decisions. They also make engaging with and monitoring of companies more difficult and expensive, as investors do not have an adequate picture of the situation of the company and cannot on that basis engage in a dialogue with the company.

4.8. Which stakeholders are affected and how?

The combined impact that of the problems described above on different stakeholders groups (listed companies, shareholders, ultimate beneficiaries) is further analysed below.

(i) Listed companies

Companies are affected in a number of ways by the problems described above. First of all, the lack of shareholder engagement and possibilities to identify shareholders makes it difficult for listed companies to know what the objectives of its investors are. They have to rely on the signals given on the market. As shown above, in practice many institutional investors and asset managers focus on trading in the short-term, which puts pressure on companies to “respond” to short term share price movements.²³⁰ Such short-term market pressure may lead to underinvestment and a company strategy focusing primarily on restructuring, mergers and acquisitions or financial engineering. In a survey of more than 400 financial executives, 80% of the respondents indicated that they would reduce discretionary spending on such areas as research and development, advertising, maintenance, and hiring in order to meet short-term earnings targets. More than 50%

²²⁶ See Developments in Corporate Governance, page 4 and 15, available at: <http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Developments-in-Corporate-Governance-in-2012.aspx>

²²⁷ Netherlands Spain, Finland, Lithuania, United Kingdom, Portugal, Latvia, France and Germany.

²²⁸ Sweden, Denmark, Czech Republic, Austria, and Estonia.

²²⁹ For more details on the situation in Member States, see Annex VI.

²³⁰ See for example CFA Centre for Financial Market Integrity and the Business Roundtable for Corporate Ethics, Krehmeyer, Orsagh and Schacht, Breaking the Short-Term Cycle, 2006, which suggest that the obsession with short-term results by investors, asset management firms and corporate managers collectively leads to unintended consequences of destroying long-term value, decreasing market efficiency, reducing investment returns, and impeding efforts to strengthen corporate governance.

said they would delay new projects, even if it meant sacrifices in value creation.²³¹ In a recent global survey of McKinsey and the Canada Pension Plan Investment Board, 63% of the business leaders said that the amount of pressure to demonstrate strong short-term financial performance has increased in the last five years. According to respondents a longer term view would increase innovation and lead to stronger financial results.²³² In this respect, a recent study on the effects of capital markets' short-termism on levels of investments²³³ documented sizeable differences in investment behaviour between listed and privately held companies. Listed companies invest substantially less (4 % of total assets, compared with 10% for observably similar privately held companies) and are less responsive to changes in investment opportunities compared to privately held firms, even during the recent financial crisis.²³⁴ The study concludes that the most important factor lies in the agency problems affecting listed companies, and more probably, short-term incentives.²³⁵

Moreover, studies demonstrate that shareholder engagement on corporate governance issues is not only creating value for the shareholders²³⁶, but contributes also to a significant improvement of the governance, operating performance, profitability and efficiency of the investee companies.²³⁷ According to the most recent meta study on sustainable investing, 100 % of existing studies agree that companies with high rating for ESG factors (environmental, social and governance) have lower cost of capital and 89% of the studies show that such companies exhibit market or accounting based outperformance. Studies demonstrate that the governance aspect had the strongest influence and good governance leads to better financial performance.²³⁸ Good corporate governance attracts investment, as certain investors have a preference for the shares of companies with good corporate governance.²³⁹ Evidence shows that successful shareholder engagement actions of a US responsible investor increases the shareholdings of other asset managers and pension funds and leads to a decrease in the investee firm's return volatility.²⁴⁰

²³¹ See Graham, Harvey and Rajgopal, The Economic implication of corporate financial reporting, Journal of accountings and economics, vol 40.

²³² D. Barton, M. Wiseman, Focusing on the Long Term, presentation 22 May 2013, page 5.

²³³ Corporate investment and stock market listing: A puzzle ? 2013, John Asker, Joan Farre-Mensa, Alexander Jungquist. The study has been elaborated on the basis of US data.

²³⁴ These differences do not reflect observable economic differences between public and private companies (such as lifecycle differences, cash holdings, debt, etc.). See also Barton and Wiseman, Focusing on the Long Term, page 8.

²³⁵ The study points out that once a company is listed, liquidity makes it easy for shareholders to sell their stock at the first sign of trouble rather than to actively monitor management. Evidence suggests that listed companies' managers prefer investment projects with shorter time horizons, in the belief that stock market investors fail to properly value long-term projects. Evidence showing that investment behaviour diverges most strongly in industries in which stock prices are particularly sensitive to current earnings reinforces these arguments. The study also provides some evidence that the presence of large shareholders may not affect managerial myopia in terms of investments.

²³⁶ Elroy Dimson et al, Active Ownership, 2012 analyses the positive effects of shareholder engagement on environmental, social and governance matters. As regards corporate governance themes, the cumulative abnormal return of a successful engagement over a year after the initial engagement averages + 7.1%. See similar results about the return generated by an active UK investor in Becht et al, 2009, Returns to shareholder activism: Evidence from a clinical study of the Hermes UK Focus Fund, review of Financial Studies 22.

²³⁷ Elroy Dimson et al, Active Ownership, 2012 finds significant improvements as to return on assets, profit margin, asset turnover and sales over employees ratios after successful engagements.

²³⁸ Sustainable investing, establishing long-term value and performance, Deutsche Bank (meta study), 2012.

²³⁹ The colors of investors' money: the role of institutional investors around the world, Miguel A. Ferreira, Pedro Matos, 2008. This is one of the reasons for the proliferation of corporate governance codes across the globe.

²⁴⁰ Elroy Dimson et al, Active Ownership, 2012.

EVCA²⁴¹ considers that the key contribution to the long-term success of the companies in which private equity funds invest comes not only from the long-term duration of their holdings but, primarily from their active ownership and the long-term perspective they bring.²⁴²

In other words, the lack of sufficient shareholder engagement leads to suboptimal financial performance of listed companies.

The lack of transparency of proxy advisors has the effect that companies' may have difficulty in understanding the reasons for certain voting recommendations, which makes it particularly challenging for them to react and explain its corporate governance approach on the relevant issue. This also decreases in practice their scope to decide what is for them the best corporate governance arrangement and might lead to 'one size fits all' corporate governance. The lack of a sufficient link of directors' remuneration with (long-term) performance of the company leads to unjustified transfers of value of the company to directors and provides company directors with incentives that are not aligned with the interest of the company, which could be detrimental to financial performance of the company. Related party transactions have a negative impact on the value of the company, since they may lead to the unjustified transfer of value to the related party. Finally, the consequence of insufficient quality of reporting on corporate governance is that company boards are not stimulated to reflect on corporate governance, which might lead to inappropriate corporate governance arrangements, and, in view of the link between corporate governance and financial performance, might negatively impact financial performance of the company.

(ii) Shareholders

For institutional investors and asset managers the impact depends to some extent on their profile. Not all investors are or will be interested in the corporate governance of investee companies. However, for a growing group corporate governance is important for their investment decisions and engagement is a part of their efforts to increase the performance of their investments. Those investors need accurate and reliable information on corporate governance and tools to engage on these issues. The problem definition has shown that such information is absent, incomplete, difficult to understand or that doubts have arisen on their reliability (remuneration, related party transactions, proxy advisors, corporate governance reporting), which could lead to uninformed (investment) decisions and suboptimal corporate governance of the companies invested in. Moreover, tools are, according to stakeholders, missing to engage on issues such as related party transactions and remuneration. The effect on shareholders is that it is more difficult (and/or costly) for them to take informed decisions, especially in case of cross-border investments and that value is unjustifiably transferred to related parties and directors. As indicated in the above paragraph on listed companies, studies demonstrate that shareholder engagement on corporate governance, with remuneration being one of the key issues, may generate an average of 7-8% abnormal cumulative and buy and hold stock return²⁴³ over a year.²⁴⁴ By analysing companies'

²⁴¹ The European Private Equity and Venture Capital Association.

²⁴² EVCA's contribution to the consultation on long-term financing, page 6. See also Barton and Wiseman, Focusing on the Long Term, page 8 who also point to this outperformance and to the fact that companies owned by private equity have more engaged directors, higher investments grades and give owners and management long-term compensation.

²⁴³ Abnormal return is calculated as the monthly stock return, minus the value-weighted market return. Buy and hold return is calculated as the return of a portfolio that buys the stock of the target company at the month of the initial engagement and sells it at the month when the company implements change in its governance (1year).

fundamental value and long-term prospects and engaging on that basis, investors act not only in their own interest, but also fulfil an important social function by helping companies to take decisions that will contribute to their long-term success.²⁴⁵

The lack of certainty about whether or not votes get through the complex chain of intermediaries administering securities accounts and the disproportionately high cost of voting across the borders discourage shareholders to use their voting rights, which is one of the most efficient direct tools to exert influence on the management

(iii) Ultimate beneficiaries

From the perspective of ultimate beneficiaries, the impact of the insufficient engagement of institutional investors and asset managers, the lack of sufficient transparency and shareholder oversight on remuneration and related party transactions, but also the insufficient transparency of proxy advisors and corporate governance reporting may also be considerable. The ultimate beneficiaries are, in most cases, not directly affected by these corporate governance problems, since they often do not directly manage their assets. However, these problems result in high costs of asset management, in lost potential for better corporate governance and thus for better results of the investments resulting finally in missed opportunities for growth, jobs and sustainability of the EU economies. In the end these problems have an impact on EU citizens who are future pensioners, insured, but also employees.

In particular, the cost of intermediation in the equity investment chain decreases the ultimate return to final beneficiaries from their investments. Studies say that active management fees and their associated trading costs based on 100% annual turnover erode the value of a pension fund by around 1.0% per year.²⁴⁶ Pension funds are having their assets exchanged with other pension funds at a rate of 25 times in the life of the average liability for no collective advantage, but at a cost that reduces the end-value of a pension fund by around 30%.²⁴⁷ EuroFinuse²⁴⁸ considers that one of the root causes of the destruction of the value of pension savings is the misaligned interests within the investment chain and the high costs of intermediation. They highlight the case of a Belgian occupational pension fund which wiped almost a fifth off the real value of the fund between 2000 and 2012, mainly due to commissions paid to intermediaries.²⁴⁹ Moreover, the lack of transparency of institutional investors and asset managers leads to less well-informed investment decisions of final beneficiaries and to a lack of accountability.

²⁴⁴ Shareholder activism (including both successful and non-successful engagements) on environmental, social and governance matters put together generate a one-year abnormal return of +1.8%, comprising +4.4% for successful and 0% for unsuccessful engagements.

²⁴⁵ A fresh survey of 2012 from the UK National Association of Pension Funds covering pension funds managing assets of more than £ 300 billion finds that shareholder engagement is adding value to their fund and has influenced changes in the investee company. See also Mercer, “Responsible Investment’s second decade: Summary report of the State of ESG information, policy and reporting”, 2011: pooling results from 36 studies, it shows that 30 studies evidenced a neutral to positive relationship between ESG (environmental, social and governance) factors and financial performance.

²⁴⁶ Paul Woolley, ‘Why are financial markets so inefficient and exploitative — and a suggested remedy’, in: *The Future of Finance: The LSE Report*, 2010, page 134.

²⁴⁷ Ibidem, page 24.

²⁴⁸ The European Federation of Financial Services users.

²⁴⁹ EuroFinuse's contribution to the Green paper on long-term financing, page 5. Pension funds across many European countries have delivered negative real (inflation-adjusted) returns averaging of minus 1.6 per cent in the years 2007-2011, according to the OECD, *Pension's Outlook 2012*, OECD. See also *The real return of private pensions*, EuroFinuse, 2013.

In addition, disproportionately high costs for cross-border voting by the asset owner/asset manager through the complex chain of intermediaries maintaining securities accounts adds to the costs of intermediation for the ultimate beneficiaries.

5. BASELINE SCENARIO, THE EU'S RIGHT TO ACT AND JUSTIFICATION

5.1. Baseline scenario

The different problems identified in this impact assessment are likely to evolve in different ways, not only at the EU level, but also at a Member State level.

The current EU rules applicable to institutional investors and asset managers²⁵⁰ do not sufficiently take into account the relevance of these investors for the corporate governance of listed companies, and in particular they do ensure transparency of the policies and practices of asset owners and managers. For example, asset managers managing assets on the basis of discretionary mandates regulated by the MIFID Directive are to disclose costs and associated charges to clients²⁵¹, however there is no specific mention about portfolio transaction costs.

In the absence of an EU and Member State framework a few, predominantly self-regulatory Codes have been created to stimulate shareholder engagement²⁵² that attempt to change behaviour of asset owners and managers, such as in particular the UK Stewardship Code²⁵³, the Eumedion best practices for engaged shareholders²⁵⁴, the European Fund and Asset Management Association principles for the exercise of ownership rights in investee companies²⁵⁵, the International Corporate Governance Network model contract between asset owners and their fund managers²⁵⁶, and the German BVI Code.²⁵⁷ These Codes are diverse and only two of them (the German BVI Code, the ICGN model mandate) cover issues such as portfolio turnover. These initiatives may focus asset owners and/or managers more on engagement. It is difficult to assess their precise impact, also in view of the fact that a number of these initiatives are relatively recent. However, these initiatives have different contents, they cover different groups of not all asset owners and managers and not all Member States. In other words, they do not lead to a level playing field for institutional investors and asset managers. With regard to reported impact of the best known and arguably most successful initiative, the UK Stewardship Code, evidence seems to suggest that it did not really result in a change in the investors' attitude towards engagement. In a recent survey, 79% of responding FTSE 350 companies reported *no increase in engagement* since the introduction of the Code, with the remaining 21% reporting only a slight increase²⁵⁸, despite

²⁵⁰ See annex XII.

²⁵¹ Article 19 of MIFID. This article is applicable to asset managers managing portfolios on the basis of discretionary mandates. The implementing Directive 2006/73 specifies what costs should be disclosed; however, it applies only to retail clients and does not make reference to portfolio turnover costs.

²⁵² For more details, see Annex VI.

²⁵³ Available at <http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-September-2012.aspx>

²⁵⁴ See http://www.eumedion.nl/en/public/knowledgenetwork/best-practices/best_practices-engaged-share-ownership.pdf

²⁵⁵ http://www.efama.org/Publications/Public/Corporate_Governance/11-4035%20EFAMA%20ECG_final_6%20April%202011%20v2.pdf

²⁵⁶ See https://www.icgn.org/images/ICGN/Best%20Practice%20Guidance%20PDFS/icgn_model_mandate_mar2012_short.pdf

²⁵⁷ [Wohlverhaltensregeln des BVI, at: http://www.bvi.de/fileadmin/user_upload/Regulierung/Wohlverhaltensregeln.pdf](http://www.bvi.de/fileadmin/user_upload/Regulierung/Wohlverhaltensregeln.pdf)

²⁵⁸ FT/ICSA Business Bellwether survey, see <http://www.ft.com/cms/s/0/9ec5594c-6f8f-11e1-b368-00144feab49a.html>.

the fact that virtually the entire UK asset management industry declared its commitment to the Code.

As regards remuneration of directors, the Commission Recommendations are applied partially but not all Member States have adopted rules that ensure better disclosure or that grant shareholders a say on pay. In many of those Member States the existing situation would most probably remain as it is, although individual companies or stock exchanges may decide to change their internal rules. The current situation could therefore evolve in increasingly divergent legislation and practices in Member States.

Although the current framework on related party transactions is subject to criticism and debate at the international, European and Member State level, there is no coherent and common approach to this issue. Possible improvements depend thus fully on initiatives of individual Member States and companies. For instance, in Italy (2010) and the Netherlands (2013) the relevant rules were recently modified. Also here, the current situation could evolve in increasingly divergent legislation in Member States. For proxy advisors, ESMA recommended self-regulation of the sector within the two coming years, with an adoption of a code of conduct by the proxy advisors. Since the industry itself is responsible for the drafting of this code and its application in practice it is difficult to predict how the problem would develop without EU intervention, although some improvement is likely. In addition, Member States may adopt their own legal or soft-law framework on proxy advisors. As regards corporate governance reporting, and in particular the quality of explanations for deviations, some Member States already issued guidelines providing specific recommendations on the desired quality of explanations. It could be expected that more Member States would follow this path. However, improvements will be limited to certain Member States and the different approaches to this issue will not make it easier or less costly for investors to monitor the investee companies. It could also mean that the EU law concept of 'comply or explain' would be given a diverging interpretation.

It is highly unlikely that Member States' action alone could be sufficient in tackling the issue of a proper shareholder identification and channelling of voting information and instructions through the complex international chain of intermediaries administering securities accounts. Only limited progress can be made through voluntary market standards, e.g. Market Standards on Corporate Actions Processing and Market Standards on General Meetings.²⁵⁹ The implementation of such voluntary market standards is slow due to its complexity and the need for increased coordination between Member States such as the existence of a legal basis for them in national legislation. Similarly, the Code of Conduct for Clearing and Settlement does not apply to intermediaries (it only applies to CCPs and CSDs) and where it is applicable, the results are not optimal.²⁶⁰ As most of the problems in this area are cross-border in nature (such as the disproportionate cost imposed for channelling information across the borders and uncertainty as regards the possibility to disclose the identity of the shareholder), EU action is necessary.

In conclusion, without action at EU level the problems are likely to persist and only partial and fragmented remedies are likely to be proposed at national level.

²⁵⁹ The Market Standards for Corporate Actions Processing were endorsed in 2009 and being implemented. They cover the most common and complex corporate actions, on stocks (e.g. dividend payments, early redemptions, stock splits) and on flows (e.g. transformations). The Market Standards for General Meetings were endorsed in 2010 and are currently being assessed against market practices and the legal and regulatory requirements that exist.

²⁶⁰ *The Code of Conduct on Clearing and Settlement: Three Years of Experience*, Commission Services Report to ECOFIN, 6.11.2009, p. 4, concludes that "... price comparability remains difficult in view of underlying differences of business models" and that "the reasons for this are broadly historical, as each CSD has developed its own business model in isolation, and as a result label their services differently."

6. EU'S RIGHT TO ACT, SUBSIDIARITY AND PROPORTIONALITY, RESPECT FOR FUNDAMENTAL RIGHTS

Article 50(2)(g) of the Treaty on the Functioning of the European Union (TFEU) gives the EU competence to act in the area of company law and corporate governance. It provides in particular for coordination measures concerning the protection of interests of companies' members and other stakeholders, such as creditors, with a view to making such protection equivalent throughout the Union.

According to the subsidiarity principle, the EU should only act where the objectives of the proposed action cannot be achieved sufficiently by Member States and where the objectives can be better achieved by the EU. As shown in the policy context section, the EU equity market has to a very large extent become an European/international market, with some 44% of total EU market capitalisation in the hands of foreign investors, in particular of foreign institutional investors and asset managers. Moreover, also asset management is very concentrated in a small number of Member States, with 66% of all assets being managed in the three largest Member States. These developments have only been partially followed by the further development of the EU (legal) framework in the area of corporate governance, in order to protect, in these changed circumstances, the interests of shareholders and other stakeholders. From the different consultations held by the Commission it becomes clear that there is strong support from shareholders, institutional investors and asset managers, but also from other stakeholders, for measures to protect their interests: more transparency and effective tools. Targeted further development of the EU legal framework for corporate governance would further stimulate the cross-border holding of shares and foreign direct investment, but at the same time create a better framework for shareholder engagement.

As regards this engagement, as well as the reliability of proxy advisors, in view of the international nature of activities of these players, the objectives cannot be sufficiently achieved by Member States. Action from Member States can only cover some of the institutions concerned and would most likely lead to different requirements, which could lead to an uneven level playing field on the internal market, but also potentially create, due to the existence of different rules, administrative burdens for the institutions concerned. Moreover, final beneficiaries and other investors would in many cases not receive the necessary information to take informed decisions. The objectives can therefore be better achieved by the EU. The existing EU measures related to engagement of institutional investors and asset managers only cover only some specific aspects.²⁶¹ With regard to the 'comply or explain' approach, the main features of this concept of EU law should be interpreted in a uniform manner throughout the EU, which cannot be (efficiently) achieved through action at Member State level.

On the objectives to ensure sufficient transparency and shareholder oversight on directors' remuneration and related party transactions, stakeholders and in particular institutional investors and asset managers ask for greater harmonisation in this area and in particular for more transparency and a shareholder vote. The existing Member State rules in these areas are very different and as a result, they provide an uneven level of transparency and protection for investors, which could lead to unjustified transfers of value and directors' incentives that are insufficiently aligned with shareholders' interests. In both cases, the result of the divergence of rules is that investors are, in particular in the increasingly normal case of cross-border holdings of shares, subject to difficulties and costs when they want to monitor companies and engage with them. Moreover, they lack sufficiently effective tools to protect their investments. Although this does not mean that they do not invest across-borders, it does mean that the current regulatory

²⁶¹ See annex XII.

framework inhibits them to play a more optimal role in the corporate governance of listed companies. Common standards at EU level are therefore necessary to promote a well-functioning internal market and avoid the development of different rules and practices in the Member States.

The problems regarding the barriers and difficulties in identifying shareholders and channelling of voting information and instructions through the complex cross-border chain of intermediaries administering securities accounts are European in nature. The different constituencies in the chain may not be required by national law to transfer information across the borders and uncertainties remain regarding the ways in which such intermediaries are expected to fulfil their obligations, especially across the borders. Therefore, in order to ensure a swift and cost-effective channelling of information and instructions through the cross-border chain of intermediaries, EU intervention is necessary.

The proportionality of possible action will be examined in sections 7 and 8. Moreover, the actions will, where possible, be in line with developments in Member States.

The following Articles of the EU Charter of Fundamental Rights are relevant for the policy options discussed below: Article 7 (respect for private and family life), Article 8 (protection of personal data), and Article 16 (freedom to conduct a business). Certain aspects of this initiative might have a limiting impact on one or more of these rights but the Commission will demonstrate that any negative impact may be justified and would not result in a violation of these rights, which are not absolute in nature.

7. OBJECTIVES

The overarching objective of this initiative is to contribute to the long-term sustainability of EU companies and to the creation of an attractive environment for investors in order to contribute to growth, jobs and EU competitiveness. In the light of the analysis of the risks and problems above, the general objectives are in particular to:

- Improve the governance and (financial) performance of EU listed companies;
- Contribute to enhancing the long-term financing of companies through equity markets;
- Improve the conditions for cross-border equity investments;

This requires the realisation of the following more specific objectives:

- Increase the level of engagement of asset owners and asset managers with their investee companies;
- Create a better link between pay and performance of company directors
- Enhancing transparency and shareholder oversight on related party transactions;
- Ensuring reliability and quality of advice of proxy advisors;
- Facilitate the exercise of rights by shareholders.
- Improving the quality of information on corporate governance provided by companies;

The specific objectives above require the attainment of the following operational objectives:

- Lower turnover of asset managers' portfolios; higher level of shareholder engagement actions
- Greater correlation between directors' pay and company performance
- Lower number of unjustified related party transactions and better protection of minority shareholders
- Better transparency of proxy advisors on the methodologies for the preparation of their voting recommendations and their handling of conflicts of interest, increased number of higher quality recommendations;
- Create a European legal framework for identification of shareholders and ensure timely transmission of information and rights by intermediaries
- Reduce cross-border price discrimination
- Ensure a higher level of useful explanations of deviations of national corporate governance codes

8. POLICY OPTIONS, IMPACT ANALYSIS AND CHOICE OF PREFERRED OPTION

This section contains a description of relevant policy options that have been considered with the view to attaining the objectives set out in the previous section. It also provides an analysis of impacts of different options and their comparison in terms of effectiveness, efficiency and coherence, as well as impact on different stakeholder groups.

8.1. Increase the level of engagement of institutional investors and asset managers

8.1.1. Description

Option 1 – No policy change – would mean that no action at EU level would be undertaken.

Option 2 – Recommendation on transparency of institutional investors and asset managers

Asset owners would be encouraged to publish to which extent their investment strategies are in line with the best long-term interests of their beneficiaries and how they incentivise their asset managers in asset management mandates to act in the best interest of their final beneficiaries and to engage with investee companies. They would be recommended to publish information regarding issues such as shareholder engagement, including engagement policy and the outcome of engagement actions, voting records, performance evaluation of asset managers used, expected and actual levels of portfolio turnover, stock-lending, use of proxy advisors etc.

Asset managers would be encouraged to disclose to which extent their investment strategies are in line with the investment horizons of their clients and to disclose information on engagement and voting policy and records, portfolio concentration, portfolio turnover, actual and estimated cost of portfolio turnover and whether the level of portfolio turnover is in line with the agreed investment strategy.

Option 3 – Mandatory transparency of institutional investors and asset managers – would introduce the same transparency measures for institutional investors and asset managers as option 2, but in the form of binding rules.

8.1.2. *Analysis of impacts and choice of preferred option*

Option 1 – No policy change

This baseline scenario is discussed in paragraph 5.1. This option does not appear to be an effective approach for dealing with the problems. The current legal framework and self-regulatory initiatives have not been effective in solving the problems.

Option 2 – Recommendation on transparency of institutional investors and asset managers

The information to be provided under this option would enable final beneficiaries to make better informed decisions and to evaluate the extent to which the investment strategies defined by the asset owner are aligned with their interests. Moreover, it would stimulate asset owners to reflect more about these issues and to engage more with investee companies. Asset owners would be able to make better informed investment decisions and be able to verify whether the asset manager implements the agreed investment strategy and assess its consequences in terms of costs, turnover etc. Transparency on the costs of frequent portfolio turnover may reduce the magnitude of such transactions, contributing to a better focus on longer-term performance and more shareholder engagement. These measures may ultimately result in cost savings and potentially a better return for asset owners.²⁶²

This option leaves a lot of flexibility to Member States, but provides at the same time a European standard in this area. The effectiveness of this option depends on its application in practice. It is not unlikely that its application in practice would be different from Member State to Member State, which could be detrimental to the EU level playing field for these investors that often work cross-borders.²⁶³ The impact on Member States would thus depend on their own follow-up to the recommendation.

As a result of such transparency mainstream asset managers might have to refocus some of their activities. On the other hand responsible asset managers, having a strong record of integrating governance (and more broadly environmental, social and governance matters (ESG) and engagement into investment strategies may benefit from these measures. In this respect these investors would on the basis of the non-financial information proposal of the Commission already have better information on these matters, but such responsible investing would be further stimulated. This option could have a positive impact on companies, since institutional investors and asset managers will be incentivized to engage more and to reflect about the basis (fundamental value or short-term perspective) and consequences of their investment decisions. Disclosure of voting and engagement policies of institutional investors and asset managers could facilitate dialogue between them and listed companies. Moreover, more focus on the fundamentals and the real value-creating capacity of companies could in particular be beneficial for listed SMEs. SMEs seem to be more affected by current investment strategies which do not allow the performance of investors to diverge too much from an index benchmark, so that investment decisions are taken on the basis of the structure of a certain benchmark. European

²⁶² This has been emphasised by many during the preparatory consultations of the Commission. See also an example of Aviva Investors market practice: Neil Brown, Steve Waygood, Making the right decision, ICGN yearbook, 2011

²⁶³ The European fund management industry is highly internationalised. Asset owners and managers invest into companies across the borders within and outside Europe. Funds can be domiciled in one country, managed in a second and sold in a third. An indicator for this is that the United Kingdom, Germany and France have a 66% market share in the area of asset management.

capital markets are reported to perform well in terms of providing a venue for trading in blue chips, but they do not seem to provide sufficient liquidity for SMEs.²⁶⁴

This option is also likely to have positive social impacts. In particular, for pensioners or insurance policy-holders, more engaged institutional investors and asset managers and a better focus on long-term absolute performance will, according to studies²⁶⁵, contribute to a better financial performance of listed companies and could thus contribute to more sustainable pension- and insurance systems. More engagement and a longer-term perspective could also contribute to higher investments by companies and thus more employment.

This option would entail administrative burden for institutional investors and asset managers.²⁶⁶ The costs of publication of engagement and voting policies and information on the main features of asset management mandates should not be substantial, as this would concern only the publication of a statement on the policies adopted by the concerned institution and making public already available information. In line with previous Commission estimation, the cost of preparing such publications would range between 600 and 1000 euros per year.²⁶⁷ A more significant burden could, depending on the level of detail required, lie in the publication of voting records. A detailed disclosure could, for a large institutional investor with 2000 holdings, create between 15.000 euro and 20.000 euro of costs. Costs would be significantly lower (approximately 500 euro) if they are required to draft and disclose an aggregated overview of their voting behaviour (number of general meetings attended, % against management proposals and some 'highlights' (e.g. remuneration). Total costs for an institutional investor with concentrated holdings (approx. 80), disclosing the detailed voting behaviour would also amount to approximately 500 euro.²⁶⁸ Similarly, the requirement for asset managers to disclose information on the investment horizons, engagement and voting policy and records, portfolio concentration, portfolio turnover, actual and estimated cost of portfolio turnover portfolio turnover and its costs would not be very high. Moreover, EU legislation already requires, for some asset managers, to disclose information on investment strategies and costs.

This option would not affect fundamental rights: the publication would not involve personal data and thus not impact the right to protection of personal data.

Option 3 – binding rules on transparency of institutional investors and asset managers On substance this option is similar to option 2. However, it would be in a binding form, for which reason it would be more effective. Binding rules ensure that the same transparency obligations will apply across the EU, which ensures an EU level playing field and should facilitate cross-border investment. As one of the key underlying problems is information asymmetry, this can only be dealt with through uniform transparency measures. Finally, existing rules for institutional

²⁶⁴ According to the Federation of European Stock Exchanges (FESE), 13% of Europe's largest companies account for 93% of Europe's market capitalisation, 85% of the number of trades and 96% of turnover. Moreover, the great majority of new trading venues only offer trading in blue-chips. FESE is of the opinion that EU capital markets focus more on the trading of blue chips, i.e. the largest traded companies – at the expense of the needs of the much more numerous but smaller listed companies that play a critical role in growth and employment in Europe. It is argued that one of the reasons for this trend lies in the short-term incentives in the investment chain. See the contribution of FESE to the Green paper on Long-term financing.

²⁶⁵ Referred to in the problem definition.

²⁶⁶ More details on the level of administrative burden are provided in Annexes VIII.

²⁶⁷ See to this effect CRD IV Impact Assessment, Administrative burden for credit institutions and supervisors, http://ec.europa.eu/internal_market/bank/docs/regcapital/CRD4_reform/IA_directive_en.pdf

²⁶⁸ If there is no requirement for an external check on the information, then the cost would be limited and would represent a few hours of staff time to run the report, check it for accuracy and prepare it for publication on the website.

investors and asset managers contain only a limited number of transparency obligations in this area.

Stakeholder views emphasise the efficiency of transparency measures to achieve a better alignment of interest between institutional investors and asset managers. For example, Eurosif²⁶⁹, in its contribution to the green paper on long-term financing states that in order to create incentives for changing asset management for a better alignment of interest and more shareholder engagement, asset owners need to disclose their investment philosophy and to what extent and how they incorporate long-term considerations (...) Contractual details that drive asset management behaviour are important in this context such as the use of short-term benchmarks²⁷⁰. In addition, asset owners need more disclosure and incorporation of long-term strategies from their asset managers. Asset managers equally need to increase disclosure and improve incentive mechanisms²⁷¹.

On the other hand, binding rules are less flexible for institutional investors and asset managers.²⁷² In this respect, as the binding transparency requirement would cover all institutional investors and asset managers, a comply or explain regime would need to be introduced as the business model of some asset managers is not necessarily focussing on achieving results in the longer term and on shareholder engagement. The measures would thus in no way prescribe an investment policy of investors; also long-term investors are interested in short-term performance.

The impact on Member States depends in particular on the number of institutions, their market share and the applicable framework in their Member State. European Asset management is highly concentrated in the UK, France and Germany, which account for 66% of the total assets under management in Europe. This option would therefore have the largest impact on these Member States and in particular the UK with a 36% market share.²⁷³ As far as asset owners are concerned, the biggest impact for pension funds can be expected in the UK and the Netherlands, where the size of pension assets is 67% of total assets of EU pension funds. As regards the number of pensions funds the UK, Ireland, Netherlands and Spain have the highest number of pension funds covered by the IORP Directive.²⁷⁴ For insurers the biggest impact can be expected in France, the UK and Germany that together have 65% of assets of European insurers and 43% of the number of insurers.²⁷⁵ In view of the fact that voting and engagement policies are more practised in the UK and the Netherlands it is expected that particularly these Member States would find it the easiest to adapt to this approach. As regards the administrative burden, they

²⁶⁹ European Sustainable Investment Forum, page 10.

²⁷⁰ Page 14.

²⁷¹ Page 10.

²⁷² This approach is however much more flexible than the US approach where certain institutional investors and asset managers have interpreted legislation as requiring them to vote in general meetings. This method has been criticized for creating a system where ‘economic decision making have been effectively decoupled from voting decisions throughout most of the investment management world’ See C.M. Nathan, P. Metha, Latham & Watkins LLP, *The Parallel Universes of Institutional Investing and Institutional Voting*,). It has been argued that mandatory voting has created a system where asset managers vote for compliance reasons, largely following the recommendations made by proxy voting agencies.

²⁷³ Asset management report 2013 of the page 5.

²⁷⁴ See the statistical survey of PensionsEurope, available at <http://www.eifr.org/Statistics.aspx>. The UK IORPs have some 1,176 trillion of assets and the Netherlands 801 billion. German IORPs have the third largest asset with 138 billion. Total assets of EU IORPs are some 2,395 trillion. See also OECD’s Pension markets in Focus, page 4, which shows the relative size of pension fund assets in comparison to GDP in which the Netherlands and UK are the Member States which have the largest percentage with respectively 138,2 and 88,2%.

²⁷⁵ Total investments portfolios of EU insurers is 7,24 trillion euro of which France, the UK and Germany hold some 1,7 trillion, 1,6 trillion and 1,4 trillion. See <http://www.insuranceeurope.eu/uploads/Modules/Publications/eif-2013-final.pdf>, page 57.

would remain the same as for option 2, however in case of binding rules they would concern most likely a larger number of asset owners and asset managers.

Overview of costs implications: transparency of institutional investors and asset managers on their voting and engagement and certain aspects of asset management mandates		
Publication of engagement and voting policies and information on the main features of asset management	Publication of voting records and past engagement	Disclosure of relevant information by asset managers
Approximately 600 - 1000 € per year + website publication ~ 70 €. Mostly one-off costs	Detailed: 15.000 to 20.000 € Aggregate overview of their voting behaviour: 500 €	Very limited – dependent from strategy, no estimation possible

The table below summarises the assessment of the policy options:

Assessment of policy options			
	Effectiveness	Efficiency	Coherence
Option 1: no policy change	0	0	0
Option 2: recommendation on transparency of institutional investors and asset managers	+	+	+
Option 3: binding rules on transparency of institutional investors and asset managers	++	+	+
<i>Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; – – strongly negative; – negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable</i>			

Assessment of policy options by stakeholders group				
	Companies	Institutional investors)	Asset managers	Ultimate beneficiaries
Option 1: no policy change	0	0	0	0
Option 2: recommendation on transparency of institutional investors and asset managers	+	+	-/+	+
Option 3: binding rules on transparency of institutional investors and asset managers	++	++	-/+	++

In the light of this assessment, it appears that the most appropriate option at this stage would be **option 3 (binding rules on transparency of institutional investors and asset managers)**, which would increase awareness of final beneficiaries, asset owners and asset managers of these issues and by ensuring transparency enables them to take informed investment decisions.

8.2. Create a better link between pay and performance

8.2.1. Description

With regard to the creation of a better link between pay and performance, the option of soft-law was discarded during preliminary analysis. The Commission has adopted three recommendations on this subject, but they have not produced sufficient results.

Option 1 – no policy change – means that no new action would be undertaken at EU level and the existing recommendations would continue to apply.

Option 2 – binding rules on transparency of remuneration – implies a minimum harmonisation of disclosure requirements.

Information should be disclosed on the remuneration policy, in particular on its objectives, adoption process, its link with long-term performance and business strategy and how it contributes to the long-term performance of the company. It should include information on the breakdown of fixed and variable remuneration, on performance criteria and on the parameters for annual bonus schemes or non-cash benefits.

Information should also be disclosed on individual remuneration paid and all its components such as fixed pay, variable pay, stock options, retirement benefits and all benefits in kind. Potentially sensitive information should however be explicitly excluded in order not to disproportionately interfere with the private and family life of individuals. A common template regarding the disclosure of remuneration should be used to ensure comparability for investors across the EU.

Option 3 – shareholder vote on remuneration – means that there should be, in addition to the transparency measures of option 2, an ex-ante shareholder vote on the remuneration policy and an ex-post vote on the remuneration report.²⁷⁶ The vote should be an explicit item on the agenda of the annual general meeting. The shareholders vote could be advisory, which means that the boards would not be obliged to follow it, or binding, which means that the board would not be able to derogate from it.

8.2.1. *Analysis of impacts and choice of preferred option*

Option 1 – no policy change. Maintaining the current framework is not likely to solve the problems described in the problem definition. The recommendations on remuneration did not produce sufficient results, since only 6 Member States have implemented all the main principles thereof. As a result, shareholders face difficulties to be properly informed and to exercise their control over directors' pay, which results in pay that is insufficiently linked to performance.²⁷⁷

Option 2 – binding rules on transparency of remuneration. Providing shareholders with clear, comprehensive and comparable information on remuneration policies and individual remuneration of directors would help them in exercising effective oversight. Disclosure of information is an important precondition for aligning the incentives of directors with the interest of shareholders. It allows shareholders to assess the main parameters and rationale for the different components of the remuneration package, notably the link between pay and performance.

Increased transparency is supported by stakeholders and experts. In reply to the 2011 Green Paper, shareholders, institutional investors, asset managers and proxy advisors almost unanimously supported mandatory rules to increase the transparency of remuneration policy and report and, also, called for making the information on remuneration comparable in Europe.²⁷⁸ Companies are however generally less in favour of increasing transparency. The majority of Member States that answered to the consultation were in favour of a European action to increase transparency²⁷⁹, a minority of Member States is of the view that remuneration should be dealt with by the board.²⁸⁰ The European Corporate Governance Forum recommended the mandatory disclosure of remuneration policy and individual remunerations.²⁸¹ The European Company Law Experts pointed out in 2011²⁸² that, in the absence of binding rules, companies are reluctant to

²⁷⁶ The remuneration policy determines on which criteria individual remunerations are granted while the remuneration report describes how the remuneration policy was applied in the previous year.

²⁷⁷ The Dutch corporate governance monitoring committee noted in its latest report of 1 October 2013 that in general the remuneration structure and policy is not simple and transparent and that the committee has not been able to bring any improvements in this. See page 21 of the report. See <https://docs.google.com/viewer?url=http://www.mccg.nl/download/?id%3D2199>

²⁷⁸ See Annex III. Support for disclosure was also expressed by respondents to the Green Paper on corporate governance in financial institutions published in 2010.

²⁷⁹ In particular France, Germany, Ireland, Latvia, Netherlands, Norway, Portugal, United Kingdom and Spain.

²⁸⁰ Austria, Czech Republic, Denmark, Estonia, Finland, Lithuania, Latvia, .

²⁸¹ Statement by the ECGF of 23 March 2009:

http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf-remuneration_en.pdf

²⁸² Statement by the ECLE of 2011:

provide full disclosure concerning remuneration, particularly on the pay/performance link and on termination payments.

Harmonisation of disclosure requirements at EU level would be a remedy to asymmetry of information which is detrimental to shareholders and, therefore, plays a key role for minimising agency costs. It would be beneficial for cross-border investment, since it would facilitate comparison of information and make engagement easier and thus less costly. Moreover, it would make companies more accountable to other stakeholders like employees. For the argument that individual disclosure of director pay can lead to an upward pay spiral, there is, according to the OECD, little hard evidence.²⁸³

As regards the impact on Member States it is noted that 15 Member States already foresee disclosure of remuneration policy and 11 foresee disclosure of individual remuneration, which would mean that the impact on these Member States would be relatively limited.²⁸⁴ This option would entail certain administrative burdens for listed companies.²⁸⁵ However, these burdens should be limited. As regards disclosure of the remuneration policy companies already have, implicitly or explicitly, such a policy. Since the preparation for publication of the policy should take approximately 2 to 4 working days, average cost would be between 525 and 1050 euro. In addition, it should be noted that remuneration policies are normally not revised on a yearly basis, which means that costs will be lower after the first year and then only reach the initial level after a revision of the remuneration policy. As regards the remuneration report, which involves a disclosure of individual remunerations granted, the preferred option foresees a degree of standardisation of the disclosure; these costs would however be very limited, since this requirement is only a matter of presentation of the information disclosed. In line with previous estimations made by the Commission's services for comparable disclosures²⁸⁶, the preparation of such additional statement in the annual report would range between 600 and 1000 euros per year per company. However, the additional burden flowing from this option would be much lower, since companies are already required to report on the amount of remuneration paid to members of the administrative, managerial and supervisory bodies in the annual accounts²⁸⁷; moreover, publication of remuneration reports/statements is also in general required by the Corporate Governance Codes applicable to companies listed on European stock exchanges. Finally, such standard of disclosure will make it much clearer how much is earned by each director by reference to the performance of the company, and will reduce the agency costs by limiting the time shareholders need to spend reviewing pay policy statements

Overview of cost implications: binding rules on transparency and mandatory shareholder vote	
Disclosure of the remuneration policy	Remuneration report

²⁸³ http://ec.europa.eu/internal_market/consultations/2011/corporate-governance-framework/individual-replies/ecle_en.pdf

See OECD (2011), Board Practices: Incentives and Governing Risks, Corporate Governance, OECD Publishing, <http://dx.doi.org/10.1787/9789264113534-en>, p. 39

²⁸⁴ See the overview in the problem definition.

²⁸⁵ More details on the level of administrative burden are provided in Annex VIII

²⁸⁶ See to this effect CRD IV Impact Assessment, Administrative burden for credit institutions and supervisors, http://ec.europa.eu/internal_market/bank/docs/regcapital/CRD4_reform/IA_directive_en.pdf

²⁸⁷ See Art. 17 (1) (d) of the Accounting Directive 2013/34/EU. The Directive allows however Member States not to apply this requirements when the information makes it possible to identify the position of a specific member of such a body..

Approximately 525 - 1050 €	Approximately 600 - 1000 €
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This option is unlikely to have a specific impact on the availability of new directors. Although transparency of individual remuneration might be difficult to accept for certain directors, the remuneration is not changed by disclosure. The high level of disclosure of individual remuneration required in certain markets, such as US or Australia, did not negatively impact companies' ability to attract competent directors.²⁸⁸

This option should overall have a rather positive impact on the competitiveness of European companies²⁸⁹: more transparency on pay could contribute to a stronger link between pay and performance and decrease unjustified transfers of value to directors. Better aligned interests of directors and shareholders could also contribute to better financial performance of companies and strengthened corporate governance. The positive impacts would thus appear to clearly outweigh the limited costs and burdens.

This option could have also an indirect positive social impact. More transparency on remuneration could increase well-informed social dialogue and accountability of companies towards stakeholders and increase the long-term sustainability of companies.

This option requires the processing of certain personal data and therefore touches upon the fundamental rights to privacy and protection of personal data of directors. The processing of personal data must always be carried out in accordance with national data protection laws implementing EU data protection law, particularly Directive 95/46/EC.²⁹⁰ The Commission has considered the possibility of introducing less intrusive alternatives, such as for instance requiring an aggregated disclosure for the entire board of directors where only the number of directors and the total remuneration would be indicated. Such disclosure would however not fulfil the objectives of the initiative, since it would not allow shareholders to assess the link between pay and performance and to remedy potential situations where an individual director seriously underperforms.

Option 3 – shareholder vote on remuneration. Granting shareholders a vote on pay would give them an effective tool to oversee directors' remuneration and engage with companies. Thus, it would contribute to aligning the interests of directors with those of shareholders and help to avoid unjustified transfers of value to directors. The vote on the remuneration policy would ensure that shareholders can have a real influence on shaping important aspects of this policy, while the vote on the remuneration report allows them to control the execution thereof.

Such a vote can be advisory or binding. The difference in practice might be less important though, as even an advisory vote sends a strong message to the board of directors or supervisory board. It encourages the board to negotiate the remuneration policy upstream with major shareholders and to revise the remuneration policy to avoid further negative votes, in other words to engage on this issue. A binding vote gives more importance to shareholders and studies show

²⁸⁸ See also OECD (2011), Board Practices: Incentives and Governing Risks, Corporate Governance, p. 27 and following.

²⁸⁹ More details on the impact on competitiveness are provided in Annex IX.

²⁹⁰ Directive 95/46/EC on the protection of individuals with regard to the processing of personal data and on the free movement of such data.

that such vote creates a stronger link between pay and performance than an advisory vote²⁹¹; on the other hand, it could in some Member States lead to a transfer of powers from certain corporate bodies to shareholders. A number of Member States already gives shareholder a binding vote on remuneration policy (Belgium, Bulgaria, Hungary, Latvia, Portugal, Slovakia, Sweden, United Kingdom and the Netherlands), whereas others (Czech Republic, Spain and Italy) have an advisory vote. As set out in the problem definition, studies suggest that shareholder approval creates a better link between pay and performance of directors.

Consultations conducted by the Commission show a strong support for the shareholder ‘say on pay’ from most stakeholder groups.²⁹² Shareholders, institutional investors, asset managers and proxy advisors almost unanimously supported a say on pay.²⁹³ However, a majority of companies were not in favour of granting a vote on shareholders. A small majority of Member States responding was in favour of granting such a right to vote,²⁹⁴ while a small majority suggested that more evidence and studies were needed before considering the idea of imposing rules.²⁹⁵ The support for say on pay is also evident from the study on monitoring and enforcement practices on corporate governance²⁹⁶, which shows that 95% of responding investors favour enhanced rights to vote on remuneration. The European Corporate Governance Forum also recommended²⁹⁷ a shareholder vote on remuneration policy.

The OECD good governance principles²⁹⁸ recommend that shareholders should be able to make their views known on remuneration policy and, according to the OECD, it is increasingly good practice for remuneration policies and implementation measures to be subject to binding or non-binding shareholder votes. Experience of OECD countries suggests that the effectiveness of ‘say on pay’ depends on active, informed and capable shareholders and providing institutional shareholders and asset managers with incentives and cost effective means for exercising shareholder rights.²⁹⁹ When it comes to directors’ pay, shareholders do exercise their rights. Average EU dissent in general meetings is the second highest for remuneration.³⁰⁰ Academic studies³⁰¹ have also found that the level of dissent concerning resolutions on remuneration is higher than against other company resolutions and that companies with the highest paid CEOs have seen higher levels of dissent.³⁰² For example, in the UK in 2009, around one fifth of

²⁹¹ See the problem definition.

²⁹² Feedback Statement, see Annex III. Support was also expressed by respondents to the Green Paper on corporate governance in financial institution and remuneration.

²⁹³ These stakeholders were almost equally divided between those advocating an advisory and those in favour of a binding vote.

²⁹⁴ France, Ireland, Latvia, Netherlands, Norway, Portugal and Spain.

²⁹⁵ Denmark, Finland, Lithuania, Germany, United Kingdom, Czech Republic, Austria and Estonia.

²⁹⁶ Monitoring and Enforcement practices on Corporate Governance in the Member States (p.163): http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf.

²⁹⁷ Statement by the ECGF of 23 March 2009: http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf-remuneration_en.pdf

²⁹⁸ Principle II.C.3.

²⁹⁹ OECD (2011), Board Practices: Incentives and Governing Risks, Corporate Governance, OECD Publishing, <http://dx.doi.org/10.1787/9789264113534-en>, p. 39.

³⁰⁰ It was in 2010 6,7%. Only votes on share plans have a higher average dissent, namely 8,9. ISS, 2010 Voting Results Report: Europe, page 10.

³⁰¹ Conyon, Martin and Graham Sandler (2010), “Shareholder Voting and Directors’ Remuneration Report Legislation: Say on Pay in the UK”, Corporate Governance: An International Review, 18(4), pp. 296-312.

³⁰² In the 2007-2011 period there were 68 examples of remuneration reports which received in excess of 30% of shareholder votes against – three times the average level of dissent. In addition, in many cases, shareholders choose to ‘abstain’ on the vote on the remuneration report to signal their discontent without going so far as to vote against management.

FTSE100 companies had more than 20% of their shareholders withhold support for their remuneration reports.³⁰³

This option would entail, in addition to those related to transparency which are estimated under option 2, some very limited costs for companies, namely the organisation of the shareholder vote. In practice, companies would have to add one additional point on the agenda of their general meeting. Certain indirect costs may nevertheless need to be taken into account, linked in particular with dealing with the potential consequences of the negative vote and with discussions with important shareholders that will most likely be intensified. However, these costs would appear to be rather limited.³⁰⁴ Also, there will be no familiarisation costs as companies already deal with binding votes on a number of key issues, including director re-election. Finally, a shareholder vote will make engagement with companies over pay easier and will reduce the agency costs.

As regards the impact on Member States it is noted that 13 Member States already foresee some kind of shareholder vote, which suggests that the impact of a shareholder vote in these Member States would therefore be relatively limited.³⁰⁵

This option should have no negative impact on the availability of new directors, as the vote itself does not necessarily result in a decrease of the level of remuneration. Companies and shareholders will retain flexibility and will still be able to reward excellent performance. Member States (in particular United Kingdom and the Netherlands) that have introduced say on pay didn't face any obvious detrimental impacts on their ability to attract talented directors. This is also true outside Europe, since Australia and the United States have introduced say on pay without knowing any negative effect on the availability of new directors.

There should be no negative impact on the competitiveness of European listed companies, including listed SMEs. As suggested by studies, say on pay would lead to a stronger link between pay and performance and have a positive impact on the sustainability of companies. Shareholders could use their new power on remuneration to push directors to perform on the short term. To counterbalance such use of 'say on pay' it is foreseen that companies should explain the link of the remuneration policy with long-term performance and business strategy and how it contributes to the long-term performance of the company.

As the previous, this option could indirectly have a positive social impact. Concerning the impact of this option on fundamental rights, the vote on the remuneration policy and report would not affect fundamental rights, but for the transparency of the report the same assessment has to be made as for option two.

³⁰³ PwC, Executive Compensation: Review of the Year, 2009. Available at:

http://www.pwc.co.uk/eng/publications/executive_compensation_review_of_the_year_2009.html.

³⁰⁴ See also the Impact assessment on Shareholder votes on executive remuneration made by the United Kingdom, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31374/12-648-shareholder-votes-executive-remuneration-impact-assessment.pdf

³⁰⁵ In Member States with a two tier system the supervisory board sets the remuneration for the members of the management board and shareholders oversee the remuneration of the members of the supervisory board. Granting shareholders the right to vote on remuneration policy and report might be seen as depriving the supervisory board, in which employees may be represented (e.g. Germany and Austria), of an important prerogative. However, it would still be the (supervisory) board that would propose shareholders the policy and, most important, it would, on the basis of the policy, decide on the actual remuneration to be paid. In line with the general system of a two-tier system the supervisory would subsequently be accountable to shareholders. It is also noted that data on directors' remuneration from Austria quoted in the problem definition, do not show a link between pay and performance.

Assessment of policy options			
	Effectiveness	Efficiency	Coherence
Option 1: no policy change	0	0	0
Option 2: binding rules on transparency of remuneration	+	+	+
Option 3: shareholder vote on remuneration	+	++	+
<i>Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; -- strongly negative; - negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable</i>			

Assessment of policy options by stakeholders group			
	Companies	Investors	Directors
Option 1: no policy change	0	0	0
Option 2: binding rules on transparency of remuneration	-	+	≈
Option 3: shareholder vote on remuneration	-	++	≈

In the light of this assessment, the preferred option is **option 3 (mandatory shareholder vote on remuneration)**, which includes the transparency measures of option 2. As the different causes for the mismatch between pay and performance are interlinked and mutually re-enforcing, there is a need to ensure both increased transparency and a shareholder vote on remuneration policy and report.

8.3. Transparency and oversight on related party transactions

8.3.1. Description

Option 1 – no policy change – means that no action would be undertaken at EU level in order to improve the control of related party transactions (RTP).

Option 2 – soft-law providing guidance – would entail the adoption of a recommendation, that provides guidance for Member States on the transparency and oversight of RPTs

Option 3 – additional transparency requirements for RPTs – would entail a binding legal framework that would require listed companies to publicly announce the most substantial transactions and provide a fairness opinion by an independent advisor for.³⁰⁶

Option 4 – shareholder vote on the most important RPTs – would give shareholders the power to approve or reject the most important related party transactions³⁰⁷, with the concerned related party being precluded from participating in the vote.

8.3.2. *Analysis of impacts and choice of preferred option*

Option 1 - No policy change. The baseline scenario is analysed above. Although discussions are on-going on different levels on the appropriateness of the current rules, there is no common approach in sight in Member States or at international level that could solve the problems described in the problem definition.

Option 2 – soft-law providing guidance. This option is likely to have some positive impact on companies' handling of RPTs. It would leave a lot of flexibility to Member States, but could contribute to a more harmonised approach on this issue. The impact on Member States would depend on their application in practice of the recommendation. Minority shareholders could benefit of the increased transparency and oversight. Its effectiveness would depend however on whether Member States would decide to follow the recommendation. In general, the impact would be lower than the impact of binding rules. As regards the costs and administrative burden, this option might entail modification by companies of existing procedures so as to improve information of investors and the procedures for approval of transactions. However, in particular providing investors with certain ex ante information could be done through the websites of companies and should not be costly.

This option would have an overall positive economic impact and consequences for economic growth and employment, as it would stimulate a better handling of related party transactions by companies and decrease the risk of unjustified transfers of value. There would be no impact on fundamental rights.

Option 3 – additional transparency requirements for RPTs Enhancing existing transparency rules on RPTs would create a more harmonised EU approach. Investors, amongst which minority shareholders, would receive timely, more, and better information, which facilitates monitoring and engagement of more important RPTs. Also other stakeholders, such as employee representatives and monitoring bodies, would benefit of increased transparency and accountability which would enable all stakeholders to take legal action against such transactions. Increased transparency could be expected to prevent unjustified RPTs, as the enhanced transparency should prevent boards from entering into more doubtful RPTs. Increased transparency would thus be a barrier against the unjustified transfer of value from companies, which in turn could have a positive effect on the competitiveness and sustainability of companies.

³⁰⁶ Such threshold could be put on 1% of total assets of the company. See the Statement of the European Corporate Governance Forum on related party transactions for listed companies, available at http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf_related_party_transactions_en.pdf

³⁰⁷ Such threshold could be put on 5% of total assets of the company. See the Statement of the European Corporate Governance Forum on related party transactions for listed companies, available at http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf_related_party_transactions_en.pdf

As explained in the problem definition there is strong support from certain stakeholders for more and better information RPTs.³⁰⁸ The European Corporate Governance Forum also recommended that transactions above a threshold of 1% of the assets should be announced publicly and be subject to evaluation by an independent advisor.³⁰⁹

The adoption of binding rules is expected to have a bigger impact than soft-law. On the other hand, this option would leave less flexibility to Member States and companies to decide on their own arrangements. In addition, providing shareholders solely with information without ensuring that they have real impact on the decision making process might not guarantee an optimal level of protection and give them the necessary tools to act against abusive transactions. For instance, court proceedings often take a long period of time and are costly.

Public announcement involves some limited additional costs for companies, including SMEs, since EU law already contains an obligation to report on RPTs in the annual report.³¹⁰ The only difference would be that under this option the transactions should be announced at the moment of conclusion thereof. The disclosure of each substantial RPT would therefore cost to a company an estimated 120 €. Administrative burden would also be linked to the requirement to have a fairness opinion on the proposed RPT above the 1% threshold transaction of an independent advisor. Depending on the complexity of the transaction and it would seem that an experienced advisor would be able to assess the fairness of the given transaction within between approximately 5 and 10 hours. This could result in a cost of maximum 2500-5000 € in case the opinion is made by an auditor. Finally, overall costs and administrative burdens would not offset the gains realised thanks to a decrease in unjustified transfer of value and the increase in legal insecurity. Based on the OECD report³¹¹ on related party transactions it would appear that each year some 15% of the listed companies could have one transaction equal or above 1% of their assets. This would mean that approximately 1550 companies should apply the foreseen rules. This option would not require further disclosure of personal data than already foreseen under EU law.

Overview of costs implications: improving transparency requirements and shareholders vote on the most important related party transactions		
Public announcement of RPTs	Fairness opinion by an independent advisor	Shareholder vote on most substantial transactions
Disclosure approximately 50 € + publication approximately 70 €	Approximately 2500 - 5000 €	No additional costs if held during AGM. Limited and ad-hoc costs if a GM must be organized.

The impact on Member States would depend on the one hand on the current rules in force and on the other hand on the number of listed companies and reported RPTs. In Spain both the percentage of related party transactions and number of listed companies is very high, (3167).³¹²

³⁰⁸ See also Annex III.

³⁰⁹ See Statement of the European Corporate Governance Forum, cited above.

³¹⁰ Accounting Directive 2013/34

³¹¹

<http://www.oecd.org/corporate/ca/corporategovernanceprinciples/relatedpartytransactionsandminorityshareholdersrights.htm>

³¹² See Annex VII, figure 2.

In Ireland and Austria, with a relatively high percentage of RPTs, the number of listed companies is relatively low (42 and 70), while in France and Poland who have a relatively high percentage of RPTs the number are higher (862 and 844). The public announcement of the RPTs would not have a major impact on any Member State, since RPTs already have to be disclosed, only the timing would be different. A report by an independent advisor on the other hand, could have a bigger impact. In a number of Member States it already exists, and from amongst the Member States with a high reporting of RPTs and a large number of listed companies France already foresees such an obligation and in Spain the regulator could request such an opinion.

Option 4 – shareholder vote on the most important transactions. Giving shareholders a right to vote on the most important RPTs would enable them to reject a related party transaction of major importance that they consider not to be in their interest. Such a vote would presuppose that shareholders have the necessary information to base their vote on. Minority shareholders would in particular be protected better against related party transactions with the controlling shareholder and directors, if this party would be excluded from the vote. Boards will be less inclined to enter into problematic related party transactions if they know their shareholder will have a say on this. Moreover, if they still do so, shareholders may reject the transaction if they deem it is not in the best interest of the company. A mandatory shareholder vote would therefore stimulate reflection of companies on RPTs and also stimulate companies to engage with shareholders. Even in relatively clear cases of unjustified RPTs, going to a court is often not attractive in view of the costs and duration of the proceedings. The shareholder vote would thus be an effective barrier against unjustified transfers of value from companies, which could have a positive effect on the competitiveness, sustainability of European companies and cross-border investment.

The impact on Member States depends on the same elements as in the previous option. The legislation of the Member States with the highest reporting of RPTs (Spain, Ireland and Austria) does not foresee a vote on related party transactions. Interestingly, the Member State with the highest percentage of reported RPTs and the highest number of RPTs (Spain) stated its support for EU action to introduce a vote of shareholders. Shareholder approval of the most substantial related party transactions could result in some limited administrative burden. In view of the fact that the threshold would be relatively high (for instance 5% of the assets), only a limited number of transactions would be subject to this obligation.

The impact of the vote could be expected to be stronger than in case of soft-law guidance or rules focusing solely on transparency. It would involve marginal additional costs for companies linked to the organisation of the shareholder vote, either in the annual meeting or a special meeting, which could however be more costly. However, the relative costs would not be significant, since such a vote would, to be proportional, only be mandatory for the most important transactions. In addition, costs and administrative burdens could be partly offset due to the fact that the stricter control by shareholders would most likely decrease the use of other remedies, such as court proceedings. This option should have no impact on the fundamental rights.

The two tables below summarise the impact of the policy options in general and per main stakeholder groups

Assessment of policy options			
	Effectiveness	Efficiency	Coherence
Option 1: no policy change	0	0	0
Option 2: soft-law providing guidance	≈	≈	+
Option 3: additional transparency requirements for RPTs	+	+	+
Option 4: shareholders vote on the most important transactions	++	++	+
<i>Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; – strongly negative; – negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable</i>			
Assessment of policy options by stakeholders group			
	Companies	Investors	Other stakeholders (employees, competent authorities)
Option 1: no policy change	0	0	0
Option 2: soft-law providing guidance	≈	≈	≈
Option 3: additional transparency requirements for RPTs	+	+	++
Option 4: shareholder vote on the most important transactions	+	++	++

In the light of this assessment, it appears that the most appropriate option at this stage would be **the combination of option 3 (improving transparency requirements for related party transactions) and option 4 (shareholder vote on the most important transactions)**. While entailing costs and administrative burden for companies, it ensures that shareholder obtain timely information on the conclusion of important RPTs and it gives shareholder the right to reject most important RPTs. This provides an effective barrier against unjustified transfers of value.

8.4. Transparency of proxy advisors

8.4.1. Description

Option 1 – no policy change – would mean that no action at EU level would be undertaken.

Option 2 – recommendation on transparency – would entail a Recommendation encouraging proxy advisors to disclose certain key information: on one hand, their policy for the prevention, detection, disclosure and treatment of conflicts of interests and on the other hand, the methodology for the preparation of advice, including in particular the nature of the specific information sources they use and how the local market, legal and regulatory conditions to which listed companies are subject are taken into account.

Option 3 – binding transparency requirements – would require compulsory disclosure by proxy advisors of the same information as foreseen in option 2.

Option 4 – detailed regulatory framework – would submit proxy advisors to specific rules regarding the treatment of conflicts of interest and methodological requirements to ensure that they act in the best interests of their clients. In addition, it would also include measures on authorisation or registration and supervision by competent authorities.

8.4.2. Analysis of impacts and choice of preferred option

Option 1 – no policy change. In the absence of EU action, further developments concerning proxy advisors would depend on actions by Member States, market developments and also on actions by proxy advisors themselves. In this context, their current work, inspired by ESMA, on a code of conduct could bring some welcome developments. Considering however the fact that the code of conduct would be made by the sector itself, would be non-binding as well as the existing lack of competition in the sector, there is a risk that the problems described will not be sufficiently tackled. In addition, action by individual Member States is unlikely to be sufficient, since the most important proxy advisors provide services on a European and even international scale.³¹³

Option 2 – recommendation on disclosure requirements. A recommendation encouraging proxy advisors to be transparent as regards their conflicts of interest and their methodology could provide an additional incentive for proxy advisors to address these concerns. Moreover, such guidance would provide a signal for international investors that the EU takes accuracy and reliability of investor information serious. It would leave a lot of flexibility to Member States, but could contribute to more harmonised approach: it could increase reliability of the advice given and could therefore give institutional investors and asset managers a more solid basis for their engagement with listed companies, especially in case of cross-border holdings. The effectiveness of this option depends however on whether Member States would decide to follow this guidance. In general the impact would be lower than the impact of binding rules.

As regards the costs and administrative burden, depending on the application this option would entail, as a maximum, the same administrative burden as under option 3. On the other hand, such guidance might not have significant added value in comparison to the baseline scenario, according to which the proxy-advisors will establish a code of conduct. Some positive economic impacts could be expected in view of the increased reliability of these important advisors to investors. No direct social impact or impact on fundamental rights is to be expected.

³¹³ For instance ISS is established in Europe in London, Paris and Brussels and Glass Lewis in Limerick.

Option 3 – binding transparency requirements. Introducing binding transparency requirements on the two main areas of concern (methodology and management of potential conflicts of interest) would put additional pressure on proxy advisors to establish adequate procedures on these crucial aspects. This option is more effective than a recommendation, also because Member States and proxy advisors would be bound to apply the principles. The importance of reliability and accuracy of the information in the investment chain cannot be overestimated and such information could have a positive effect on the competitiveness and long-term sustainability of companies. On the other hand, this option would leave less flexibility to Member State and proxy advisors to decide on their own rules/arrangements. The first consultation documents on a possible self-regulatory Code on proxy advisors shows little ambition for the sector to self-regulate. The Member States that would be most impacted by this option would most likely be the UK, France and Germany. These Member States have a large stock market both in terms of market capitalisation and number of listed companies, while they have a market share of more than two-thirds in the asset management market. Asset managers are making the most use of proxy advisors. However, Member States, nor institutional investors and asset managers would be impacted in a negative manner: the option would only increase transparency and reliability of proxy advisors.

In the context of the 2011 Green Paper there was strong support by shareholders, institutional investors and asset managers for increasing the transparency regarding the methodologies used and for addressing the widely recognised problem of conflicts of interest that was shown. Companies also called for regulation of the sector, mainly justifying it by pointing to the risk that could arise from the influence proxy advisors currently have. Furthermore, all proxy advisors that answered to the consultation³¹⁴ stated to be in favour of more transparency and the diffusion of a code of conduct. The majority of Member States that expressed their view were in favour of increasing transparency of the methodology used and addressing the conflict of interest³¹⁵, while some Member States considered this unnecessary.³¹⁶

This option would involve some administrative burden for proxy advisors, in particular due to the requirement to improve information on their internal procedures (disclosing methodology and prevention of conflict of interest) and preparing this information for publication. Normally, these costs would essentially be incurred only once and only more often if the proxy advisors would change essential parts of these policies. The preparation of appropriate information on internal procedures would in practice represent a few hours of work of staff. In addition, many proxy advisors already have internal guidelines on the relevant issues and some of them are already, at least partly, publicly disclosed on their websites. Therefore, depending on the proxy advisors and the level of adaptation for publication needed, the additional working hours estimated to prepare the disclosure of the policies will range between 20 and 50 hours, suggesting that the cost of preparing the required information for publication will therefore range, for each proxy advisors, between € 1000 and € 2500. These costs would be incurred by 10 proxy advisory firms that are active in the EU. Requiring proxy advisors to be transparent on a number of issues and not submitting them to detailed rules will not deprive proxy advisors of operational flexibility. The positive impacts mentioned in option 2 would remain with a much higher likelihood to materialise.

³¹⁴ ISS, Glass Lewis, PIRC, Proxinvest, ECGS and Computershare.

³¹⁵ Spain, Finland, Germany, United Kingdom, Estonia, Portugal, Latvia, Austria and France.

³¹⁶ Sweden, Denmark, Lithuania, Czech republic.

Overview of cost implications: Proxy advisors' transparency
Disclose methodology and conflict of interest
Disclosure approximately 50 € + publication approximately 70 €

Option 4 – introducing detailed regulatory framework. The introduction of detailed binding measures would appear, in the current circumstances, disproportionate and could even have negative effects on the development of the sector and the entry of new competitors. A directive with detailed rules might even induce Member States to add more rules, which could threaten the business model of proxy advisors and may reduce the attractiveness of such services by slowing down the provision of proxy advice. Although the impact on the reliability and accuracy of the proxy advisors' advice could be higher, there would be higher costs for investors and much less flexibility. Consultations and analysis have not revealed support for such detailed legislative rules.

The analysis of policy options is summarised in the tables below:

Assessment of policy options			
	Effectiveness	Efficiency	Coherence
Option 1: no policy change	0	0	0
Option 2: recommendation on transparency	≈	+	++
Option 3: binding transparency requirements	+	++	+
Option 4: detailed regulatory framework	++	-	-
<i>Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; – – strongly negative; – negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable</i>			

	Assessment of policy options by stakeholders group			
	Companies	Investors	Proxy advisors	Regulators
Option 1: no policy change	0	0	0	0
Option 2: recommendation on transparency	+	+	≈	+
Option 3: binding transparency requirements	++	++	-	+
Option 4: introducing detailed regulatory framework	+	+	--	+

In the light of this assessment, it appears that the most appropriate option at this stage would be **option 3** (binding transparency requirements), which would provide the highest likelihood to trigger a positive change with limited cost.

8.5. Shareholder identification, transmission of information and instructions by intermediaries

8.5.1. Description

Option 1 – no policy change – means that no new action would be undertaken at EU level.

Option 2 –defining minimum EU rules - means the introduction of mutual recognition of national investor identification systems and a non-legislative endorsement of existing market standards.

Option 3 –would establish an EU-wide mechanism of shareholder identification based on an obligation for intermediaries to provide the service of shareholder identification and oblige intermediaries to transmit information through the holding chain and to facilitate the exercise of shareholder rights. It would also require intermediaries to disclose the prices and fees of the services provided and to justify any differences in pricing between domestic and cross-border holdings

8.5.2. Analysis of impacts and choice of preferred option

Option 1 – No policy change

Without Union action, the problems identified in the area of cross-border exercise of rights and shareholder identification will remain largely unresolved as different legal rules would continue to exist within the EU. The determination of the duties of intermediaries in respect of transmission of information and monetary rights would be left to Member States. The Single Market would continue to face barriers to cross-border holdings and to the cross-border exercise

of rights. This would constrain progress towards improved exercise of shareholders' rights only for cross-border holdings between Member States with similar legal and operational systems providing the exercise of rights. Market participants would still bear the costs of remaining legal uncertainty due to persistent differences between national legislation. On a cross-border basis, companies, who under their home member state law, have the right to identify their shareholder, would continue to run the risk that their request for identification is refused by an intermediary established in another, less transparent jurisdiction. Thus, this option would not re-establish a direct relationship between the company and its shareholders. Member States would not be required to introduce any rules aimed at preventing cost discrimination and/or requiring transparency of pricing. This would prevent shareholders and companies from fully benefiting from their rights in the case of cross-border holdings. Intermediaries would continue to have the possibility to differentiate the prices of purely domestic and cross-border holdings on the basis of the geographical location of the shareholder and the place of the issuance of the shares. As price transparency would be left to voluntary self-commitment of the intermediaries, price comparability would remain difficult. Moreover, the Code of Conduct for Clearing and Settlement³¹⁷ does not apply to all intermediaries, and where it is applicable, the results are not optimal.³¹⁸

Although a better application of voluntary market standards could potentially improve the situation, it would be rather limited due to the voluntary nature of these standards (i.e. to be applied by a certain percentage of market participants) and the slow pace of implementation³¹⁹ (i.e. multiple legal obstacles in Member States which continuously delay the implementation process).

Therefore, maintaining the status quo would not solve any of the problems outlined in the problem definition and would not achieve the objectives set.

Option 2 – defining minimum EU rules

This option would, amongst others, promote existing market standards, namely the 'Market Standards on Corporate Actions Processing'³²⁰ and the 'Market Standards on General Meetings'.³²¹ These were developed by the industry and cover the main relevant constituencies, i.e. listed companies, market infrastructures and intermediaries.³²² They introduce streamlined communication and operational processes based on a best practices approach, so as to ensure that

³¹⁷ See http://ec.europa.eu/internal_market/financial-markets/docs/code/code_en.pdf

³¹⁸ *The Code of Conduct on Clearing and Settlement: Three Years of Experience*, Commission Services Report to ECOFIN, 6.11.2009, p. 4, concludes that "... price comparability remains difficult in view of underlying differences of business models" and that "the reasons for this are broadly historical, as each CSD has developed its own business model in isolation, and as a result label their services differently. Full comparability would accordingly require a significant simplification and harmonisation of the way infrastructures present their services in their fee schedules. This is difficult to achieve in view of the fundamental differences in infrastructures' business model".

³¹⁹ 5th Implementation Progress Report on The Market Standards for Corporate Actions Processing & General Meetings, February 2012

³²⁰ The Market Standards for Corporate Actions Processing were endorsed in summer 2009 and are in the process of implementation. They cover the most common and complex corporate actions, on stocks (e.g. dividend payments, early redemptions, stock splits) and on flows (e.g. transformations).

³²¹ The Market Standards for General Meetings were endorsed in summer 2010 and are currently subject to a thorough gap analysis to assess them against the market practices and the legal and regulatory requirements that exist in the different EU countries.

³²² The European Banking Federation (EBF), the European Association of Cooperative Banks (EACB), the European Savings Banks Group (ESBG), the Association for Financial Markets in Europe (AFME), the European Central Securities Depositories Association (ECSDA), EuropeanIssuers, the Federation of European Stock Exchanges (FESE), the European Association of Clearing Houses (EACH).

information from the company reaches the shareholder and vice versa in a timely and cost efficient manner. According to the 2012 implementation report³²³, although the overall implementation process of the Standards for Corporate Actions has been kept at a high level (the compliance rate in 8 major markets is 85 to 90%), it faces many legal and operation hurdles in Member States due to differences in national rules and information requirements.

Given that the consistent and timely processing of information heavily depends on the standardisation of operational procedures and key dates used by companies and intermediaries, the Commission has always strongly encouraged market-led standardisation as it plays a primordial role for the development of cross-border investment. In the long run, standardising these processes across all EU markets would achieve a significant reduction of respective costs and operational risks (e.g. for intermediaries). These efficiency gains could be passed on to shareholders and other market participants (e.g. investors, issuers, intermediaries) would benefit from increased cross-border as well as domestic efficiency. However, in the short-term, important investments by intermediaries may be required in order to become compliant with the standards.

As reported to the Commission, the effectiveness of the implementation progress of these market standards depends very much on the existence of a legal basis for them in legislation. For example, at a meeting on September 2011, the Chair of the European Market Implementation Group stated that the Austrians have argued that without legal basis they do not even make the effort to become compliant with the standards, whereas Italians are champions in implementing the standards as the Italian regulator made the web based template developed by intermediaries compulsory for listed companies. Furthermore, according to the 5th progress report on the application of the Market Standards for Corporate Actions Processing and the Market Standards for General Meetings (February 2013), the implementation is slow and the target date of 2013 for full implementation is unrealistic. This option would therefore not achieve the objective, even if these standards were to be promoted by means of non-legislative endorsement.

The option of mutual recognition of national identification systems would ensure that where the applicable law under which the shares are constituted entitles the company to identify its investors, intermediaries would be obliged to provide the requested information. As 78% of Member States (only in Belgium, Netherlands and Germany is there no access of any sort) provide companies with some sort of access to the information on the holding of the shareholder for domestic participants³²⁴, the disclosure obligation would not result from the proposal, but would come from the applicable corporate law of the relevant issuer. The EU-wide recognition of national identification systems was not included in the 2nd public consultation, but was advocated by the T2S Taskforce on Shareholder Transparency.

It would enlarge the number of identified shareholders in cross-border scenarios when the existing national identification systems prove effective. However, it would only partially solve the problem in shareholder identification as not all shareholders would be covered, but only those

³²³ 4th Implementation Progress Report on The Market Standards for Corporate Actions Processing & General Meetings, March 2012, <http://www.ebf-fbe.eu/uploads/D0325B-2012-%20BSG-implementation-progress-report-March-2012.pdf>

³²⁴ T2S Taskforce on Shareholder Transparency, *Market Analysis of Shareholder Transparency Regimes in Europe*, version: 21.2.2011, p. 7: "Do issuers have access to information to the holding of (a) the first layer of holders; (b) the final layer of holders? Only first layer: Austria, Germany, Spain, Estonia, Finland, Sweden, Slovenia; Both first and final: Bulgaria, Switzerland, Cyprus, Germany, Denmark, Estonia, Finland, France, Greece, Hungary, Ireland, Italy, Lithuania, Latvia, Malta, Norway, Poland, Portugal, Romania, Sweden, Slovakia, UK; None: Belgium, Germany, Netherlands. The majority of countries have information going as far as the final layer for domestic participant. But in the case of foreign intermediaries, it is generally the case that only the first layer information is available. ". Nb.: In the study an 'investor' is called the 'final layer holder'.

who hold their shares under a disclosure-friendly jurisdiction. In practice this would mean that for 23% of the market capitalisation of EU listed companies no identification at all would be available (Germany, Belgium and the Netherlands), and for another significant part only information on the first layer of shareholders would be available. In some markets, e.g. Austria, Belgium, Netherlands, Spain, companies have no or only very limited information available, even on the domestic shareholder level.³²⁵

This option touches upon the fundamental right of protection of personal data (Article 8 of the Charter). Member States that currently have strong privacy rules allowing the shareholder to remain anonymous would have to make their residents reveal their identity to an entity governed by foreign law. Given that more than two thirds of Member States (all except Belgium, Netherlands and Germany) have already granted companies the right to know their domestic shareholders, this option would reduce the level of privacy protection in less than one third of Member States. In terms of financial costs, the impact would be minimal, as the national identification schemes would not have to be changed, but are only enforced on a cross-border basis. However, this option would not fully solve the problem.

Option 3 – Creation of an EU shareholder identification instrument and obligations for intermediaries to transmit information through the holding chain

The different elements of this option are closely linked, since they require action of intermediaries. Listed companies could request intermediaries in the chain to identify the shareholders. The intermediaries would be under a legal obligation to provide the identity to the next intermediary in the holding chain until the company has received the name and contact details of the shareholder. At the same time, for the obligation to transmit information and the facilitation of exercise of rights, the same intermediaries in the same chain would be used, unless the company decides, after identifying its shareholders directly contacts them.

This option would leave it to the company to decide whether or not to seek to identify its shareholders.³²⁶ In cases where the company does not request identification, the shareholder would not be able to enter into direct contact with the company for the exercise of his rights and the company would not be able to identify the shareholder itself and get into direct contact with him. It has to be noted that the Shareholders' Rights Directive does not aim at harmonising the concept of the "shareholder" or defining who the beneficial owner of a share is. In this respect, the different national regimes will continue to apply.

Over 81% of issuers who responded to a public consultation³²⁷ supported a harmonised EU system identifying shareholders. Member State authorities broadly also supported a technical

³²⁵ See footnote 280.

³²⁶ T2S Taskforce on Shareholder Transparency, *Market Analysis of Shareholder Transparency Regimes in Europe*, version: 21.2.2011, p. 12: "Do most issuers ask for shareholder information on a regular basis or do they usually limit these requests at the time of general meetings or corporate actions? Daily/regularly: Switzerland, Cyprus, Germany, Denmark, Greece, Malta (frequency varies), Norway, Portugal, UK (frequency varies). Once a month/quarterly/ad hoc (including for AGMs and CAs): Finland, France, Hungary, Ireland, Sweden, Slovakia (ad hoc), Italy (ad hoc at issuer request and mandatory for AGM and CAs), Latvia. Only AGMs and CAs: Bulgaria, Estonia, France, Lithuania, Poland, Romania (and mandatory 2x year), Slovenia. Only AGMs: Spain (but would prefer much more frequently, e.g. quarterly or even daily). Not applicable: Belgium, Netherlands. Summary: There is no set frequency. Some issuers have daily updates, while others only obtain data on a monthly/quarter basis or at AGMs or for CAs. However, it is possible that if an efficient solution were available, most issuers would ask for a high frequency".

³²⁷ *Public consultation: The EU corporate governance framework*, July 2011

and/or legal EU mechanism to help issuers identify their shareholders. During the second public consultation, investors, including pension funds, also backed an EU mechanism to identify shareholders (approx. 88% of investors' replies); however, intermediaries were not favourable to such a mechanism due to the potential increased costs and the sufficient transparency of existing national systems.³²⁸

Identification of shareholders has an impact on fundamental rights recognised in particular in the Treaty on the Functioning of the European Union (TFEU) and in the Charter of Fundamental Rights of the European Union (Charter), notably the right to the protection of personal data recognized in Article 16 TFEU and in Article 8 of the Charter.

In view of this it is necessary to strike a balance between the facilitation of the exercise of shareholders' rights and the right to privacy and the protection of personal data. The identification information on shareholders would be limited to the name and contact details of the shareholders and could only be used for facilitation of the exercise of shareholder rights. Consequently the measure would not go beyond what is necessary to achieve the objective. In the light of this, the limitation of the investor's privacy rights would be justified.

Such an EU-wide identification mechanism would entail certain costs. In 2005, the annual amount spent on shareholder identification ranged from an average EUR 9 000 per company in Denmark to EUR 36 000 per company in Spain.³²⁹ According to a recent report, in most Member States (e.g. Belgium, Bulgaria, Cyprus, Denmark, Estonia, Germany, Spain, Finland, France, Greece, Malta, Poland, Sweden and Slovenia, the Central Securities Depository is remunerated for providing the data to issuers.³³⁰ It is difficult to compare the actual level of fees due to national differences.³³¹ In any event, since this option would also entail an obligation for the intermediaries to transmit information necessary to exercise shareholder rights, it does not add any additional costs, except with regard to costs related to the processing of a disclosure request.

³²⁸ *Summary of responses to the Commission Green Paper on the EU corporate governance framework*, 15.11.2011.

³²⁹ The review of the operation of Directive 2004/109/EC: emerging issues, SEC(2009) 611, p. 94 on the ground of figures gathered by International Investor Relations Federation, 2005, p. 12.

³³⁰ T2S Taskforce on Shareholder Transparency, *Market Analysis of Shareholder Transparency Regimes in Europe*, version: 21.2.2011, p. 14: "Please describe how CSDs/registrars/issuer agents are remunerated for the work that they perform in providing shareholder information issuers? Is all or part of this remuneration retro-ceded to intermediaries or paid directly to intermediaries (i.e. banks)? Issuer pays CSD: Belgium, Bulgaria, Cyprus, Denmark, Estonia, Spain, Finland, France (and CSD in turn pays intermediaries), Greece, Malta, Norway, Poland, Sweden, Slovenia; Banks and issuers pay CSD: Switzerland, Germany; Issuer pays issuer agent: UK and Ireland; paid for through contract with issuer agent; Not applicable: Austria, Hungary, Italy, Lithuania, Latvia, Netherland, Portugal, Romania, Slovakia. Summary: In general, the CSD is remunerated for providing the data to issuers. The actual level of fees was not provided (except in the case of Spain and Germany)".

³³¹ T2S Taskforce on Shareholder Transparency, *Market Analysis of Shareholder Transparency Regimes in Europe*, version: 21.2.2011, p. 50, evidencing that the actual level of fees is hardly comparable, e.g. between Germany ("Every transaction that is recorded in the share register is remunerated to Clearstream Banking AG. The remuneration is paid one half by the issuer and the other half by the bank. Additionally every transaction that is recorded in the share register is remunerated to banks and custodians by the issuer using the Gebührenverordnungfee-table. In case a disclosure request is issued, the issuer is obliged to reimburse the bank for its necessary cost in connection with the gathering of the necessary data. The banks get 12 or 10 cent per data set / Clearstream gets 50 cent from the bank, 50 cent from the issuer for forwarding the data and providing a platform for the data transferring. There are no different fees. The Clearstream fee is levied upon any transaction only once") and, p. 69, Spain ("Notifications on transactions in their shares to issuers whose securities must by law be registered at the final beneficiary level will be subject to a fee of EUR 100 each plus VAT and when they are provided with the tallied list of buyers and sellers, an annual fee of EUR 426 plus VAT will apply, plus EUR 5 plus VAT for each daily report of this information").

For companies the impact would most importantly be that they have an additional right that they can use, but are not obliged to use. It is noteworthy that the creation of a system whereby companies could request the identification of shareholders and in which intermediaries will offer identification as a service and therefore they can charge the costs of data processing on the company, it is likely, as confirmed by EuropeanIssuers, that companies will want to identify their shareholders once or twice a year, for instance before general meetings.

Under this option all intermediaries would also have the duty to transmit, where necessary via other intermediaries, without undue delay, shareholder information from the company that is necessary to exercise a right flowing from securities, if that information is directed to all shareholders in that class. They would pass on all monetary rights attached to securities (dividends, rights issues). The information should be provided by the company in a standardised and timely manner, for instance in a brief, standardised and electronic form which would facilitate transmission of the information. This would be important since it was in practice, especially in a cross-border context, often impossible for the intermediaries to assess which part of a long document was necessary to forward and which part of the document only contained ancillary information.³³²

By requiring intermediaries to transit such information, this option would effectively ensure timely transmission of information and monetary rights by intermediaries and thus facilitate the exercise of shareholder rights. At the same time, this would limit the burden placed on intermediaries to the necessary minimum, as it would restrict the duty to pass only some information that is inevitable for the exercise of rights and companies should provide it in standardised form.

Intermediaries commonly expected this option to have repercussions on their business model. In the second public consultation the particular concern was voiced that the automatic transmission of information to all shareholders would be unnecessary, unduly expensive, and that the costs would outweigh the benefits. There would be one-off costs for adjusting existing infrastructure, notably IT infrastructure and changing the relevant internal processes. Additionally, the contractual documentation governing the relationship with account holders would need to be amended. Second, existing linkages amongst intermediaries may need to be updated, new ones established and useless or unfavourable ones abolished. On the other side, the current efforts of the financial industry to streamline the cross-border exercise of rights on an operational basis needs to be factored in. In this context, infrastructure, procedure, documentation and links will be revised anyway.

The ongoing costs involved in passing on information have been analysed in the German law on the compensation of reimbursement of credit institutions which specifies the sums.³³³ Depending on the market size, these costs may represent a not insignificant burden (e.g. 20 000 for every 100 000 letters sent to clients). The quantification of ongoing costs for intermediaries can be based on some national laws which would provide a cost per letter of EUR 0.20 - 3 depending on the distribution channel used and how much information sent,³³⁴ but they can, from their side charge

³³² Examples provided by UniCredit in response to second public consultation.

³³³ German Verordnung über den Ersatz von Aufwendungen der Kreditinstitute. in aggregate, EUR 2 per forwarded letter by more than 30 and up to 100 letters in aggregate, EUR 0.95 per forwarded letter by more than 100 and up to 5 000 letters in aggregate, EUR 0.55 per forwarded letter by more than 5 000 and up to 50 000 letters in aggregate, EUR 0.45 per forwarded letter by more than 50 000 letters in aggregate. Electronic forwarding EUR 3 per forwarded mail by up to 30 mails in aggregate, EUR 1 per forwarded mail by more than 30 and up to 100 mails in aggregate, EUR 0.40 per forwarded mail by more than 100 and up to 5 000 mails in aggregate, EUR 0.25 per forwarded mail by more than 5 000 and up to 50 000 mails in aggregate, EUR 0.20 per forwarded mail letter by more than 50 000 mails on aggregate.

³³⁴ German Verordnung über den Ersatz von Aufwendungen der Kreditinstitute.

costs for these services. Intermediaries would have to "duly justify" any differences in pricing between domestic and cross-border holdings and to disclose to their clients the prices and fees of the services provided

On the saving side, there is the possibility of a considerable cut of expenses. At the moment, processing information is more expensive in a cross-border context as differing standards do not allow the introduction of standardised procedures and still a considerable amount of manual and paper work is required. This means that savings due to simplification on the side of the industry are able to offset the cost identified above. The fact that industry itself works on standardisation in this field shows that it expects this cost to be compensated by the savings. The impact of this option on Member States would be negligible.

As regards the facilitation of the exercise of rights by the shareholder, this obligation would address the situation where the shareholder needs assistance from its intermediary in order to exercise his rights, e.g. to be able to participate and vote in a general meeting or where it wants the intermediary to vote on his behalf. Intermediaries would be bound to administer instructions with regard to the essential rights of shareholders. It would have an important positive impact not only on the cross-border exercise of rights but also at national level.

For intermediaries, the costs involved would be proportionate, as not all, but only the most important rights would be covered. This would not prevent investors from agreeing on a contractual basis with intermediaries on a broader range of services. This would significantly improve the efficiency of the Single Market and provide for increase standard of service by intermediaries. This flexibility would allow investors to make these decisions based on their individual expected utility, without imposing the corresponding costs to all other shareholders and intermediaries.

The discussion on price discrimination in the second consultation showed that the transparency of pricing of cross-border services could be significantly improved. Most stakeholders emphasised the need to ensure high levels of investor protection and system integrity . The option to prevent cost discrimination of cross-border holdings as opposed to purely domestic holdings was strongly opposed by intermediaries. It was regarded as evident that the longer the intermediary chain is, the higher the costs of the exercise of rights attached to securities will be. An obligation on price justification would improve the price formation mechanism while the increased transparency of pricing would help to reduce the high level of custody and broker fees which make respectively 22% and 71% of the equity holding and transacting costs. This has a considerable potential to promote the Single Market and create growth. On the cost side, this option would trigger compliance costs for intermediaries. However, costs incurred by intermediaries for implementation the transparency requirement would be low, especially for those who have already taken initiatives in this field, e.g. by complying with the Code of Conduct for Clearing and Settlement.

For listed companies this option would lead to some additional costs in relation to the revision of internal processes to provide standardized information to the intermediaries. However, they would be able to identify their shareholders, while increased engagement of better informed shareholders would be beneficial for the company.

For investors, including retail investors this option will greatly improve their situation, since a direct relation could be established between the company and the shareholder, the latter would receive more timely information and he will be able to exercise his rights in a much more efficient way.

On the cost side, shareholders may face higher costs (charged by their intermediaries) for the increased standard of services.

Member States will face one-off costs for amending legislative frameworks as well as ongoing costs for supervising the implementation of the legislation. The mechanism on investors' identification would uniformly impact all Member States as it would redefine existing national identification systems in order to address existing bottlenecks as well as cross-border holdings. The obligations on intermediaries and the rights of companies and shareholders would generate moderate to substantial costs for intermediaries, but these would be uniformly distributed among market players. Depending on the size of the market, certain Member States (e.g. UK, Germany, France) would face higher absolute adaptation costs but, at the same time, would benefit from important economies of scale as well as improved corporate governance of their multinational companies and enhanced investors' rights in cross-border holdings.

Assessment of policy options			
	Effectiveness	Efficiency	Coherence
Option 1: no policy change	0	0	0
Option 2: defining minimum EU rules	+	++	+
Option 3: introduction of shareholder identification mechanism and creation of transmission and facilitation obligations for intermediaries	++	++	+
<i>Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; – – strongly negative; – negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable</i>			

Assessment of policy options by stakeholders group			
	Investors	Intermediaries	Companies
Option 1: no policy	0	0	0

change			
Option 2: defining minimum EU rules	+	0	+
Option 3: introduction shareholder identification mechanism and creation of transmission and facilitation obligations for intermediaries	++	+	++

In the light of this assessment, the preferred option is **option 3** (introduction shareholder identification mechanism and creation of transmission and facilitation obligations for intermediaries).

This option creates an efficient and effective mechanism for shareholder identification, ensures efficient and timely transmission of information through the holding chain of intermediaries and facilitates the exercise of shareholder rights (e.g. voting rights). The three types of requirements on intermediaries make all use of the same existing infrastructure, ensuring productive investments. Although the requirements will be put on intermediaries, they could charge fees for the services to be provided to companies and shareholders, ensuring that those that benefit from they services also bear (part of) the costs.

8.6. Improving the quality of corporate governance reporting

With regard to corporate governance reporting and the application of the ‘comply or explain’ principle, replacing this approach by binding corporate governance rules or by an EU Corporate governance Code has not been considered a realistic option. Public consultations show that there is strong support for maintaining the current approach and improving it.

Option 1 – no policy change – would mean that no action would be undertaken at EU level in order to improve the quality of corporate governance reports.

Option 2 – recommendation providing guidance – would involve issuing a Commission recommendation providing guidelines on the quality of corporate governance reports and on the practical application of the ‘comply or explain’ approach. It would in particular provide guidance on what kind of explanations for deviations from corporate governance codes can be considered sufficient.

Option 3 – detailed requirements regarding corporate governance reporting – would mean that the current rules on corporate governance reporting contained in Article 20 of the

Accounting Directive³³⁵ would be amended and that detailed requirements on the quality of the reports and of the explanations for deviations would be introduced in the directive.

8.6.1. Analysis of impacts and choice of preferred option

Option 1 – no policy change. Under this option, there would be no common guidance on the desired quality of corporate governance reports. Eventual corrective action could be expected from the competent bodies in individual Member States. This is however likely to result in increasingly divergent approaches to corporate governance reporting and interpretation of the Directive in Member States and, as a result, in diverging quality of corporate governance reports. The level of information available to investors is likely to remain uneven which, taking into account the increasingly cross-border character of investment, is likely to have a negative impact on investors.

Option 2 – providing guidelines on the quality of corporate governance reports through a recommendation. Providing guidelines on the preparation of reports and in particular of explanations for deviations is likely to have a positive impact on the quality of these reports and on the practical functioning of the ‘comply or explain’ approach. Clear guidance on the key features of appropriate reporting and of appropriate explanations for deviation would help companies prepare such reports and would enhance the quality of information available to investors across the EU.

A recommendation would have a weaker impact than binding rules. On the other hand, flexibility is one of the main advantages of the ‘comply or explain’ approach. A recommendation would help enhancing this approach while giving the competent national bodies in charge of monitoring of corporate governance reports an important degree of flexibility to adapt, where necessary, the guidance to the specificities of the national framework. As stated in the problem definition, a very clear support for this approach was shown by all stakeholders.

This option does not entail additional administrative burden, since listed companies are already required to produce such reports and the recommendation would only clarify what is the desired quality of reports and of explanations. In fact, issuers would mainly be stimulated to apply a greater degree of diligence when preparing the statement currently required, but would also know more clearly what is expected of them, which decreases legal uncertainty. In terms of practical impact there could at most be a few additional hours of work for the relevant staff. Moreover, it should be noted that the cost will mostly be a one-off cost, since the corporate governance arrangement of companies on these aspects do not change often.

This option would have an overall positive impact on the corporate governance of companies, as it would encourage companies to undertake a more thorough reflection on their corporate governance arrangements and increase the level and the quality of information available to investors and other stakeholders. It could also contribute to cross-border investment, due to increased transparency and comparability of reports. Due to low costs, the competitiveness of European undertakings would not be affected.³³⁶ As corporate governance statements are prepared by all listed companies, listed SMEs might also be affected. However, as already pointed out, the impact would not be significant. There would be also no impact on fundamental rights.

³³⁵ Directive 2013/34/EU.

³³⁶ More details on the impact on competitiveness are provided in Annex IX.

Option 3 – introducing detailed requirements regarding corporate governance reporting through modification of the current Accounting Directive. Introducing detailed requirements for corporate governance reporting is also likely to have a positive impact on the quality of reports and of explanations for deviations.

The impact of binding rules would be stronger than in case of a recommendation. On the other hand, this option would leave less flexibility to national monitoring bodies to adapt the guidelines to national specificities and would leave less flexibility to companies to adapt the rules to their situation. Moreover, as explained above, stakeholders appear not to be in favour of legislative rules.

As the previous one, this option would not entail significant costs, since no new statements would be required. However, as it is likely to leave less flexibility to companies, possible costs and administrative burdens could be slightly higher than in case of option 2.

Similarly as option 1, this option would have a globally positive economic impact and no significant negative impacts. It entails no significant increase of costs and administrative burden and thus should have a very limited impact on the competitiveness of European undertakings, including SMEs. The two tables below summarise the impact of the policy options in general and per main stakeholder groups.

Assessment of policy options			
	Effectiveness	Efficiency	Coherence
Option 1: no policy change	0	0	0
Option 2: recommendation providing guidelines	+	++	++
Option 3: detailed rules	++	+	+
<i>Magnitude of impact as compared with the baseline scenario (the baseline is indicated as 0): ++ strongly positive; + positive; – – strongly negative; – negative; ≈ marginal/neutral; ? uncertain; n.a. not applicable</i>			

Assessment of policy options by stakeholders group			
	Companies	Investors	National monitoring bodies
Option 1: no policy change	0	0	0
Option 2: recommendation providing guidelines	+	+	+
Option 3: detailed rules	-	++	+

In the light of this assessment, it appears that the most appropriate option at this stage would be **option 2 (recommendation providing guidelines)**. While relatively effective in attaining the objective of increasing the quality of corporate governance reports, it would leave greater room for flexibility and thus only entail very low costs. It would also have positive impact on the stakeholders affected.

9. OVERALL IMPACTS OF THE PACKAGE

The proposed approach constitutes a package of complementary actions, targeting problems relating to the different players in the equity investment chain. A majority of respondents to the consultations of the Commission support the analysis of the Commission, but also the options chosen. Moreover, studies have demonstrated the existence of the problems and, at least in a number of cases, shown the best way forward. The preferred approach is fully consistent with the Commission's non-financial reporting proposal that will give investors more and better non-financial information and should strengthen the impact thereof by stimulating investors to be engaged. In this respect it is noted that engagement on corporate governance often goes together with engagement on environmental and social issues.³³⁷ Moreover, the package is part of the Commission's work on the long-term financing of the European economy: it contributes to a more long-term perspective of shareholders which ensures better conditions for listed companies.

The benefits of this package are more and better quality information on the corporate governance of EU listed companies, in particular on directors' remuneration, related party transactions and the application of national corporate governance codes and information transmitted to shareholders. Investors request such information to take informed decisions and to defend their interests. Investors would also receive more reliable information from proxy advisors, which gives them a stronger and better basis for monitoring and engaging with companies. Such information enables institutional investors and asset managers to oversee investee companies and to engage with them. Easier and cheaper ways to exercise rights, especially in a cross-border context, will also allow them to oversee companies more effectively. As suggested by studies, the shareholder vote on remuneration and related party transactions will, combined with the

³³⁷ Moreover, it is noted that the non-financial reporting proposal also cover risk management arrangements and diversity that are part of corporate governance.

increased transparency, respectively ensure a stronger link between pay and performance and prevent unjustified transfers of value to related parties.

Not only shareholders will benefit of increased transparency. Also companies will benefit from transparency of their shareholder base, institutional investors and asset managers, since they would disclose their voting and engagement policies and practices. The precise impact on (financial) performance of EU companies of these measures is difficult to estimate, since tools and information can be used in different manners and/or not used. Their use depends, amongst others, on how easy it is too make use of them. The objective of the preferred options is to ensure that investors have clear, comprehensive and comparable information at their disposition, which removes, certainly for cross-border investors, barriers to engagement. Evidence in this impact assessment shows however that there is a growing group of investors who make use of shareholder engagement to increase performance of their investments. Creating more transparency on the impact of such, but also other investment policies will result in more informed decisions of investors and final beneficiaries, but will also incentivise investors to become more engaged with their investee companies. This development could, in the longer-term also drive more mainstream investors towards an investment policy with more engagement. Any increase in shareholder engagement is likely to have a positive effect on both shareholder value and the efficiency and performance of the target company.³³⁸ Shareholder engagement on corporate governance, with remuneration being one of the key issues, may generate an average of 7-8% abnormal cumulative and buy and hold stock return³³⁹ over a year.³⁴⁰ The engagement of a single investor may thus have a significant impact on profits for investors. Such positive effect on companies will be most successful with poorly performing and under-investing firms with lower R&D expenditure. Potential benefits for company performance could also be significant. Return on assets, profit margin, asset turnover and sales over employees measures are reported to improve one year after the initial engagement by 1%, 1.5%, 2.1% and 8.8% respectively.³⁴¹ This indicates that not only shareholders value, but also operating performance of the company increases. More shareholder engagement is thus likely to contribute to significantly improved returns for the investors and lower cost of capital, improved performance, profitability, efficiency and governance for target companies.

The proposed package could thus positively impact the long-term sustainability of listed companies, including SMEs, which are likely to benefit from a better access to capital markets. Some indirect positive social impacts could also be expected, since long-term oriented companies could create more employment. Moreover, companies, institutional investors, asset managers and proxy advisors would be more accountable for other stakeholders. No direct environmental is anticipated, nor will micro-enterprises be affected.

The package would result in an increase in administrative burden.³⁴² However, these costs would be distributed evenly between the different stakeholders groups. Additional costs relate in particular to drafting, publication, or specific staff training. Some additional data may also need to be collected, although one should bear in mind that in most cases the options chosen merely

³³⁸ See Elroy Dimson, *Active Ownership*).

³³⁹ Abnormal return is calculated as the monthly stock return, minus the value-weighted market return. Buy and hold return is calculated as the return of a portfolio that buys the stock of the target company at the month of the initial engagement and sells it at the month when the company implements change in its governance (1year).

³⁴⁰ Shareholder activism (including both successful and non-successful engagements) on environmental, social and governance matters put together generate a one-year abnormal return of +1.8%, comprising +4.4% for successful and 0% for unsuccessful engagements.

³⁴¹ This data however do not separate the effects generated by corporate governance engagements from social and environmental engagements.

³⁴² More details on the impact on administrative burden are provided in Annexes VIII.

strengthen already existing legislative requirements, and the necessary systems and procedures should already be in place in many companies.

Costs for companies would be linked to disclosure of the remuneration policy and report as well as of the most significant related party transactions. Some limited costs could also be linked to the improved corporate governance reporting. The impact on the competitiveness of EU companies would therefore not be significant.

Costs would also be linked to the publication of the voting and engagement policies and application thereof for institutional investors and asset managers. Costs for proxy advisors would be linked to the publication of their policy regarding the conflicts of interests and the methodology for the preparation of advice. Those costs would also be limited. Costs for intermediaries would be linked to the EU mechanism for shareholder identification, transmission of information and facilitation of the exercise of shareholder rights, but these costs would be (partially) carried by companies and investors.

The proposed package may affect the protection of personal data of certain stakeholders (essentially directors and shareholders). This right may however be subject to limitations, which must be provided for by law and respect the essence of those rights and freedoms. Moreover, such limitations may only be made if they are necessary and genuinely meet objectives of general interest recognised by the Union or the need to protect the rights and freedoms of others.³⁴³ In line with the 2004 Recommendation on remuneration, such limitation appears to be necessary.

10. MONITORING AND EVALUATION

In order to ensure that Member States implement the proposed initiatives in a clear and consistent way, an implementation plan would be prepared. In particular, implementation workshops could be organised by the Commission to deal with questions/issues that might arise in the course of the implementation period and guidance may be issued by the Commission. The Commission will monitor the implementation of the revised Directive and of the new Recommendation. In compliance with the principle of subsidiarity, the relevant information should be gathered primarily by Member States through relevant national authorities and bodies. The Company Law Expert Group and the European Corporate Governance Codes Network (ECGCN)³⁴⁴ will be used to share information. The costs of such activity could be met from existing operational budgets, and would not be significant. Monitoring activity should involve sample reviews of corporate governance reports, including information on remuneration and on related party transactions, as well as of information published by institutional investors, asset managers and proxy advisors.

An evaluation of the effects of the preferred policy options should be carried out to see to what extent the anticipated impacts materialise. Different indicators should be taken into account, such as in particular, the level of shareholder turnout and dissent in general meetings, the quality in terms of clarity, comparability and comprehensiveness of explanations from provisions of national corporate governance codes, of remuneration disclosures and of institutional investors, asset managers and proxy advisors, price differences for exercising shareholders' rights across the borders, etc. Moreover, the impact of the preferred policy options on the link between pay and performance and the level of engagement of institutional investors and asset managers will be assessed. In terms of possible downsides it will be necessary to assess whether any companies

³⁴³ Article 8 and 52 Charter of Fundamental rights of the EU

³⁴⁴ The European Corporate Governance Codes Network is an informal network for exchange of information and good practices between national bodies in charge of monitoring the application of corporate governance codes, see <http://www.ecgc.org/Home.aspx>

have chosen to de-list from EU regulated stock exchanges as a consequence of the policy. Such an evaluation will be carried out by the Commission, on the basis of all the relevant information collected in the framework of the monitoring activities described above. Consultations with European companies, investors and other stakeholders could be carried out via existing platforms, and on an informal basis. The possibility of commissioning an external study will be considered. On the basis of the data collected, and five years after the expiration of the transposition deadline, the Commission would consider the need to produce an ex-post evaluation report. The results and feedback from monitoring and evaluation will also be considered with a view to propose further amendments where appropriate.

Annex I. Glossary

Asset managers – Person managing the assets of institutional investors and households either through investment funds, or through discretionary mandates.

Asset Owners – Institutional investors which own assets on behalf of ultimate investors.

Comply or explain – Approach taken when a company choosing to depart from a corporate governance code has to explain which parts of the corporate governance code it has departed from and the reasons for doing so.

Corporate governance codes – Non-binding set of principles, standards or best practices, issued by a collective body, and relating to the internal governance of corporations.

Discretionary mandates - Mandates giving asset managers the authority to manage the assets on behalf of an asset owner in compliance with a predefined set of rules and principles, on a segregated basis and separate from other investors' assets.

Equity - A stock or any other security representing an ownership interest.

Institutional investors - Any institution of considerable size which professionally invests (also) on behalf of clients and beneficiaries, e.g. pension funds or insurance companies.

Investment funds - Pools of assets with specified risk levels and asset allocations, into which one can buy and redeem shares.

Listed company - Companies that issue securities admitted to trading on a regulated market.

Persons acting in concert – Persons or entities who have concluded an agreement, which obliges them to adopt, by concerted exercise of the voting rights they hold, a lasting common policy towards the management of the issuer in question.

Proxy advisor – Firms providing voting services to investors including voting advice.

Related party transactions - Self-dealing transactions by corporate insiders that can either be management, directors and/or controlling entities or shareholders and their relatives.

Remuneration – Salary plus additional amounts of benefits and bonuses.

Remuneration policy – Policy defining all forms of compensation, including fixed remuneration, performance-related remuneration schemes, pension arrangements, and termination payments.

Individual remuneration – Remuneration to be attributed, individually, to directors.

Additional remuneration - Any participation in a share option or any other performance-related pay scheme; it does not cover the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with the company (provided that such compensation is not contingent in any way on continued service).

Variable components of remuneration – The components of directors' remuneration entitlement which are awarded on the basis of performance criteria, including bonuses.

Say on pay – Shareholders' right to vote on remuneration of directors.

Shareholders Engagement - The active monitoring of companies, engaging in a dialogue with the company's board, and using shareholder rights, including voting and cooperation with other shareholders, if need be to improve the governance of the investee company in the interests of long-term value creation.

Annex II. List of main EU measures in the area of corporate governance

- Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC
- Directive 2007/36/EC on the exercise of certain rights of shareholders in listed companies
- Directive 2004/109/EC of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC
- Directive 2004/25/EC of 21 April 2004 on takeover bids
- Directive 2012/30/EU of the European Parliament and of the Council of 25 October 2012 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 54 of the Treaty on the Functioning of the European Union, 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 (recast of Second Council Directive 77/91/EEC).
- Commission Recommendation 2005/162/EC of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board
- Commission Recommendation 2004/913/EC of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies
- Commission Recommendation 2009/385/EC of 30 April 2009 complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies

Annex III. Overview of responses to consultations specifically devoted to corporate governance

1. Public consultation - Corporate Governance in Financial Institutions. The consultation was launched on 2nd June 2010, together with the adoption of a Green Paper³⁴⁵. It was closed on 1st September 2010. 214 answers were received.
2. Public consultation - EU Corporate Governance Framework. The consultation was launched the 5 April 2011, together with the adoption of a Green Paper³⁴⁶. The consultation closed on 22 July 2011. In total, 409 answers were received.

REMUNERATION

Should disclosure of the remuneration policy, the annual remuneration report (a report on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors be mandatory?

Almost three quarters of respondents who provided an answer to this question agree that disclosure of the remuneration policy, the annual remuneration report and individual remuneration of directors should be mandatory. They mention that this would contribute to the level playing field in the EU and improve the comparability of disclosed information on remuneration between companies in different Member States. Respondents also often mention that measures should be taken to avoid box-ticking in relation to disclosure on remuneration.

The respondents who are not in favour of mandatory disclosure of remuneration policy, the remuneration report and individual remuneration give, amongst others, the following reasons: the issue is already sufficiently regulated in their national jurisdiction, more time is needed to see the effect of the Commission Recommendations on remuneration and such a rule would interfere with the capacity of the board to decide on executive remuneration. Some respondents mentioned that they were in particular against mandatory disclosure of individual remuneration because this would interfere with the privacy of the concerned board members and could have an upward driving effect on remuneration levels.

Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?

A small majority of respondents who provided an answer to this question agrees that the remuneration policy and remuneration report should be put to a mandatory vote by shareholders. Most of those in favour of a mandatory vote further indicate that the vote should be advisory only, although some indicate that they would prefer a binding vote. One reason cited for this is that they believe that the advisory vote which is currently being applied in their jurisdiction has not brought forward enough reform in the area. Reasons which are given by respondents who are against include that the issue is already sufficiently regulated in their national jurisdiction and that such a rule would only be useful if shareholders have become more engaged in corporate governance issues.

PROXY ADVISORS

³⁴⁵ COM(2010) 284 final, http://ec.europa.eu/internal_market/company/docs/modern/com2010_284_en.pdf

³⁴⁶ COM(2011) 164 final, http://ec.europa.eu/internal_market/company/docs/modern/com2011-164_en.pdf#page=2

Should EU law require proxy advisors to be more transparent, e.g. about their analytical methods, conflicts of interest and their policy for managing them and/or whether they apply a code of conduct? If so, how can this best be achieved?

More than three quarters of respondents who provided an answer to this question agree that EU law should require proxy advisors to be more transparent. Amongst others, respondents mentioned that proxy advisors should be more transparent about the following issues: their methodology for preparing voting advice, voting policies and records, conflicts of interest and the system in place to manage them, whether a code of conduct applies or whether there are internal rules of conduct, applicable procedures for contacting companies when preparing the advice and stewardship policies. A number of respondents believe that in particular the issue of conflicts of interest of proxy advisors should be addressed. Moreover, some respondents are of the view that proxy advisors should be required to register and become supervised entities. It was also mentioned that institutional investors should disclose when they make use of the services of a proxy advisor.

Most respondents who are not in favour of requiring proxy advisors to be more transparent mention that the issue should be addressed through voluntary or self-regulation measures. Others are of the view that this should be addressed at national level or would prefer to investigate the issue in more detail before committing to action.

Do you believe that other (legislative) measures are necessary, e.g. restrictions on the ability of proxy advisors to provide consulting services to investee companies?

A small majority of respondents who provided an answer to this question believe that other measures are necessary to address conflicts of interest of proxy advisors. A number of respondents suggested that there should be mandatory separation of services to investors and services to companies, while a few respondents mention that it should be disclosed if proxy advisors also provide services to investee companies. Respondents who provided a negative answer to the question said that the issue could be addressed through self-regulation or codes, or were of the opinion that the issue would be resolved if there were sufficient disclosure on conflicts of interest.

RELATED PARTY TRANSACTION

Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?

The slight majority of respondents that provided an answer to this question, in particular companies, business federations, the banking and financial services sector, share the view that sufficient safeguards are already in place and that, accordingly, there is no need for regulatory intervention. In their view, the focus, if any, should be on clarifying and simplifying existing rules on related party transactions. Furthermore, respondents suggest first to assess the impact of new regulation before taking new measures into consideration. Some respondents stress that the general meeting is not the right place to discuss transaction agreements.

The slight minority of respondents in favour of more protection consider that more and better information on related party transaction is necessary. They also share the view that related party transactions above certain thresholds (at least) should be subject to ex ante board or shareholder approval with interested parties being excluded from voting. Many respondents think that

common principles should be introduced at EU level on the basis of the ECGF Statement³⁴⁷. Some respondents insist on the need of an independent opinion on the transaction or wish to see the auditors' role extended and strengthened. Others, in particular retail investors, suggest the introduction of an EU procedure when shareholders are squeezed-out.

COMPLY OR EXPLAIN

Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?

The large majority of responses were favourable to requiring companies departing from the recommendations of corporate governance codes to provide detailed explanations for such departure. Better quality of these explanations should be provided by companies (i.e. explanations should be meaningful and informative).

Several respondents indicated the Swedish model as being an adequate solution to tackle the current shortcomings in the "comply or explain" principle.

The justifications for the negative responses were that there is no need for further provisions as the existing ones suffice, it should be left to the Member States to deal with the matter, developments are already moving into this direction, the market should have its saying on the level of detail, difficulties in providing an alternative solution, etc. In addition, some respondents considered that the issue is sufficiently dealt with at the national level.

Many respondents expressed their position against compulsory rules. Some respondents underlined the need mostly for clear, rather than detailed explanations.

Do you agree that monitoring bodies should be authorised to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If yes, what exactly should be their role?

Most of the responses to the present question were against authorising monitoring bodies to check the informative quality of the explanations in the corporate governance statements and to require companies additional explanations if need be.

A large number of those against consider that there are already control mechanisms, such as shareholders, boards, auditors, etc to assess the information. Others deem that there is no need for regulation or that it would be incompatible with the "comply and explain" principle. Practical difficulties relating to the monitoring of the quality of explanations have also been raised (e.g. costs to set them up, definition of roles, enforcement/difficult to measure 'informative quality', etc.) and different measures such as recognition and award or to stimulate in general a continuous improvement have been proposed as an alternative.

Certain respondents referred to the Danish, French and Italian experience which should be assessed before deciding on the matter.

³⁴⁷ Statement of the European Corporate Governance Forum on Related Party Transactions for Listed Entities (10 March 2011).

Some respondents who replied positively to the present question considered that the "comply or explain" principle would work better with a sound monitoring process and that uniform sanctions would be needed in order to ensure efficient enforcement.

INSTITUTIONAL INVESTORS

Should disclosure of institutional investors voting practices and policies be compulsory? How often?

The vast majority of respondents that provided an answer to this question are in favour of mandatory disclosure of voting policies and records by institutional investors

They consider that such disclosure would have a positive impact on the awareness of investors, optimise investment decision of ultimate investors, facilitate issuers' dialogue with investors and encourage shareholder engagement. However, certain respondents are relatively cautious with regard to public disclosure of voting records for confidentiality reasons.

A number of respondents think that the disclosure should be done at least on an annual basis, with voting records being disclosed after each general meeting of the invested company. There are also some voices in favour of half-yearly or even quarterly disclosure.

Those respondents which are opposed to disclosure by institutional investors of their voting policies and records either feared that such disclosure obligation for a specific category of shareholders would be contrary to the principle of equal treatment or thought that it should be left for each institutional investor to decide on whether to disclose or not its voting policy.

Should institutional investors be obliged to adhere to a code of best practice (national or international) such as, for example, the code of the International Corporate Governance Network (ICGN)? This code requires signatories to develop and publish their investment and voting policies, to take measures to avoid conflicts of interest and to use their voting rights in a responsible way.

The majority of respondents that provided an answer to this question think that institutional investors should adhere to a code of best practice, whether to national, European or international code, at least on a "comply or explain" basis. A number of respondents consider the UK Stewardship Code as being a model for investor codes of best practice. Some respondents are of the opinion that there is a need either for a European code of best practice or for a common standard at European level with mutual recognition of national stewardship codes.

One respondent thinks that self-regulatory codices are not a viable means to assure the quality of corporate governance. In his view, responsibility of external control should lie with the supervisory authorities and external auditors.

ADDITIONAL RELEVANT ELEMENTS

Are there measures to be taken, and if so, which ones, as regards the incentive structures for and performance evaluation of asset managers managing long-term institutional investors' portfolios?

This question was only answered by around half of the respondents to the consultation. A small majority of respondents who provided an answer to this question agrees that there is a need to take measures with regard to fee and incentive structures of asset managers. Most of the respondents who are in favour of measures would prefer legislative measures, while a few have

mentioned that they would prefer to address the issue in a code or through self-regulation. Even some respondents who did not support measures in this field indicated that a code or self-regulation might be a better way of addressing these issues. Some also mention the UK stewardship code and are of the opinion that this code will catalyse improvement. Respondents who are against measures in this field also give as reasons that it is for the parties to the asset management agreement, the investors and the asset management company, to negotiate and decide on the terms of the agreement and the incentive and fee structures included therein.

As regards which measures could be taken to address fee and incentive structures and performance evaluation of asset managers, many of the respondents, who are in favour of taking measures, are of the opinion that there should be more transparency about the fee and incentive structure and/or that asset managers should more clearly report on this to their clients. It was mentioned that reporting to clients should clearly set out all elements of the fee structure and show how fees are linked to longer term performance and how incentives are aligned to investors' objectives. Some respondents also mentioned that the incentive structure should be better aligned to investors' interests and that it should include a broader set of indicators. Some respondents also noted that it might be useful to educate investors on what to look for in an effective asset manager.

Should EU law promote more effective monitoring of asset managers by institutional investors with regard to strategies, costs, trading, and the extent to which asset managers engage with the investee companies? If so, how?

This question was answered by about half of the respondents to the consultation. Of the respondents who provided an answer to this question, about half said they were in favour of EU regulations promoting more effective monitoring of asset managers by their clients. The other half said they did not favour such regulations, yet some of them supported measures subject to the "comply or explain" principle. Of those in favour of EU action, most mentioned that it is necessary to increase transparency on asset managers' policies and the exercise of their duties. Respondents have, amongst others, suggested increased transparency on voting policy, investment policy, exercise of rights attached to securities, engagement activities, costs, including management costs, cost of trading or churning the portfolio and incentive structures, risk and (potential) conflicts of interest. Some also mentioned that more consistency is needed as regards disclosure by asset managers in the EU.

Should EU rules require a certain independence of the asset managers' governing body for example from its parent company, or are other (legislative) measures needed to enhance disclosure and management of conflicts of interest?

This question was answered by about half of the respondents to the consultation. A majority of respondents who provided an answer to this question is not in favour of EU rules which require a certain independence of the asset managers' governing body or any other measures to enhance disclosure and management on conflicts of interest of asset managers. Many respondents who are not in favour of EU rules to address this issue point out that they find the existing conflicts of interest rules for asset managers sufficient, or that existing rules should be better enforced.

Of the respondents who provided a positive answer to this question, most mentioned that they would support further conflicts of interest rules. A number of respondents added that they would also support rules which require a certain independence of members of the asset managers' governing body. A few respondents mentioned it is necessary to disclose it when an asset manager is not an independent institution.

Annex IV. Summary of ad hoc discussion with stakeholders

1. OVERVIEW

In December 2012 the European Commission has adopted the Action Plan on European Company Law and Corporate Governance.

As a follow up, the Services of the Commission engaged in informal discussions with a number of stakeholders in order to consider how to better achieve the goals set out in the Action Plan, namely on measures aimed at increasing long-term shareholder engagement and transparency between management and shareholders. The aim was to collect the views and receive an early feedback of practitioners and experts and to benefit from their insight and expertise in the field of corporate governance in general and shareholder engagement in particular. In order to cover all interest groups and to receive a diversified feedback a variety of stakeholders were invited to these roundtable debates, such as asset owners, asset managers, issuers, proxy advisors, consultants, stock exchanges, public authorities, customers, employees and trade union representatives. The roundtable debates took place in Brussels between Tuesday the 29th of January and Friday the 1st of February.

The subsequent summary of the roundtable debates gives an overview of the main issues and arguments raised by the stakeholders. It outlines their most frequent observations and main concerns regarding the actions set out in the Action Plan, especially a possible revision of the current directive on the exercise of certain rights of shareholders in listed companies (2007/36/EC).

2. SUMMARY/ DETAILED ANALYSIS OF RESPONSES

a) Shareholder engagement

All participants acknowledged that, in the past years, shareholders have often been insufficiently engaged with companies and did not exercise sufficient oversight over management. Therefore, all stakeholders said that shareholder engagement is an important issue of corporate governance and that more and better shareholder engagement could enhance the European corporate governance framework.

Some participants explained the fact that the majority of investors do not engage with the “free rider problem”. Others explained the lack of shareholder engagement with market failures and missing incentives for institutional investors to engage. Especially in an environment of highly diversified portfolios, a lot of participants saw difficulties for institutional investors to engage in single companies or to monitor in depth the asset managers. Thus, a concentrated investor portfolio was generally regarded to be beneficial for shareholder engagement but at the same time found to be more risky. Therefore, it was not recommended to impede the diversification of portfolios or to prescribe concentrated portfolios. In addition it was pointed out that rules such as Solvency II or MIFID lead to more diversification as they do not allow offering a concentrated portfolio to a risk adverse investor.

Besides that, institutional investors and their relationship to asset managers were generally regarded to be of major importance for the debate concerning shareholder engagement.

Some experts asked to bear in mind that sometimes the “financial literacy” among institutional investors is surprisingly low and that financial products in general tend to become more and more complex and more difficult to understand.

Furthermore, there was a widespread agreement throughout the participants that effective shareholder rights are a key prerequisite for shareholder engagement. In this context, a number of experts referred to the U.S. where they considered shareholder engagement to be weak, which – to their mind – is due to weakness of shareholder rights.

In exchange for more shareholder rights some recommended that shareholders should be subject to obligations comparable to those set up in the “UK Stewardship Code” which was also paraphrased as “Ownership Code”. Some argued with respect to the UK Stewardship Code that it is just one example which should not be imposed on whole Europe as the European markets are very different and no “one size fits all”. Moreover, it was argued that there is a lack of resources in the institutional investors industry to offer stewardship. According to that, asset managers already publish reports, but asset owners do not have sufficient time and resources to analyse information.

Others pointed out that engagement in general and stewardship in particular should be competitive issues by creating marked demands for engagement and stewardship. It was suggested to create this demand by going beyond the UK Stewardship Code on the basis of a European “opt in” standard concerning engagement – possibly on a “comply or explain basis”. Thus, an acknowledged standard would create a level playing field for the financial industry. Others suggested enhancing stewardship and engagement by making clear that fiduciary duty includes these issues.

b) “Long-term” shareholder engagement

There was a widespread recognition amongst the members of the roundtable debates that the focus of shareholder engagement should be placed on the quality of the engagement and not on the quantity as shareholders in the past tended to concentrate on short-term profits. Therefore some participants proposed to grant asset owners financial incentives for their long-term engagement. Others pointed out that the asset managers are important players as well. Thus, one should turn to them if the engagement policy of asset owners should be shifted towards long-term perspectives. It was argued that the average mandate for asset managers is 2-3 years which was not seen as long-term. Therefore it was proposed to design the mandate given to the asset managers in a way that they enhance engagement in general and long-term engagement in particular.

Moreover, it was argued that short-term incentives are sometimes even generated by legislation, such as Solvency II. Others mentioned that the common understanding of fiduciary duties (that is to say the obligation to act in client’s best interest) is a possible impediment for long-term shareholder engagement. In this context it was argued that long-termism is nothing else but an accumulation of short-term events and that sometimes it is a fiduciary duty to sell shares spontaneously, e.g. when a share prize is highly overestimated. Therefore, some stated that it is difficult to encourage more long-term investment in equities in a system that is short-term orientated (e.g. investors relying on daily figures or quarterly reports).

Moreover, it was noticed that all investment strategies somehow relate to benchmarks which tend to define the fiduciary duty. It was criticised that the fiduciary duty has become the duty to follow the rest of the industry which promotes herd behaviour. Furthermore, it was argued that due to the herd behaviour (caused by the fiduciary duties), anomalies in corporate governance might remain

undetected and little events might add up to a crisis (black swan problem). Hence some proposed to revise the definition of fiduciary duty and also to take long-term perspective and ESG (environmental and social governance) factors into account. In this context, some criticised average main-stream investors as they look at corporate governance and risk management in a traditional sense whereas responsible investors have a broader understanding of risks and also take diversity, long-term and ESG-issues into account.

Some argued that the correlation between good corporate governance and long-term profitability might be difficult to prove as benefits of long-term engagement take a long time to materialize. It was stated that a good long-term effect of shareholder engagement is also difficult to prove as there are many issues influencing the performance of a company. Some pointed to the instance that there might also be cases in which shareholder engagement turned out to be bad for the long-term perspective of a company. Others underlined that short-term investors do not always have a bad influence and that they are also crucial for the smooth functioning of the system.

c) Transparency of voting policies and engagement policies

Most participants regarded the disclosure of voting policies to be an important issue and recommended a disclosure at least on a “comply or explain” basis. Some also recommended that transparency and disclosure requirements should also entail non-financial issues such as ESG-risks. Some participants considered that the disclosure of engagement is a difficult topic and that disclosure at a policy level might be appropriate whereas disclosure of engagement records might sometimes be harmful to engagement. These participants believed that discussions between shareholders and companies are best conducted on a confidential basis. Therefore, there shouldn’t be any disclosure requirements concerning on-going engagement activities and such engagement activities should only be disclosed ex-post on a more generalized and aggregated basis. In this context some participants stated that engagement activities can take several years. Therefore it was recommended only to disclose backward looking and summarized information, or information where shareholders and management have reached a successful conclusion or they are finally stuck in a conflict (and no longer speak to each other). In the latter case, it was argued that public disclosure (to the media) can be used by the shareholder as a means of putting pressure on the board.

Furthermore, some stated that a mandatory disclosure of voting records will practically force people to vote which could have at least two effects. First, it could have a detrimental impact on the quality of votes being cast. Secondly, it could increase the influence of proxy advisors.

d) Proxy Advisors

With respect to proxy advisors, the participants admitted that they are an important link in the chain and that certain players in the equity chain need their advice. It was asserted that especially foreign investors tend to rely on their advice. Thus, it was reasoned that the more international a financial market becomes the greater is the need for proxy advisors and that proxy voting is still better than thoughtless voting.

However, a lot of participants criticised that the proxy advisor industry isn’t subject to any rules. On the other hand, it was pointed out that the proxy advisor industry is small and that overregulation could make it shrink. Therefore, some proposed a code of conduct, which could be established by self-regulation. Others proposed that the Commission should endorse such a code and that the code should apply on a “comply or explain” basis.

Some said that there is a lack of transparency as to how proxy advisors operate and reach their decisions. Moreover it was argued that proxy advisors might apply very different standards in different markets, which could create a problem of lack of continuity of advice. Furthermore, some reported on possible conflicts of interest as proxy advisors often have multiple and incompatible duties (also as CG advisors, proxy agents, etc). In this context, the relationship between proxy advisors and proxy solicitors (the former gets paid to advice on votes, the latter gets paid to raise votes) was regarded to be potentially problematic. Therefore, it was proposed that conflict of interest should be disclosed as well as the measures the proxy advisor took in order to prevent such conflicts. With respect to disclosure, some stated that problems might arise if proxy advisors were obliged to disclose their recommendation to issuers before the AGM. In this situation, it could be possible for issuers to outwit or fool the proxy advisors.

Moreover, it was said that proxy advisors usually only have one model of advice, although they ought to offer a variety of recommendations based on the preferences of individual investors.

e) Remuneration

Questions on remuneration and the disclosure of remuneration raised a lively debate. Most participants argued that there should generally be more information and disclosure on the structure of payment, although some expressed their concerns that transparency in this field might lead to a general pay increase. Many regarded it to be problematic that the disclosure requirements concerning remuneration differ throughout the European Member States. In particular, in the southern countries, the disclosure on remuneration was seen to be bad. Therefore, many recommended a European wide standardization of the disclosure on remuneration. Some participants believed that a standardized disclosure would make the information more comparable throughout the different Member States which could also have a positive effect on cross-border activities.

As a remuneration package often comprises fix and variable parts as well as pension plans, some saw practical difficulties in establishing a system of full and comprehensive disclosure reducing the complexity of a remuneration system to a single figure or a range of expected payments. Others argued that it should at least be possible to present full and comprehensive information on 4-5 pages.

In the view of some, it would be good to introduce a general principle according to which one can only pay on the basis of a remuneration policy in which the remuneration can be valued beforehand. As a result, remuneration policy should not be adopted if it is not possible to determine the real value of a pay-package. It was said that such a rule would for example prevent the use of leveraged share schemes.

It was proposed that a disclosure should also reflect the sustainable payment criteria and non-financial (ESG) factors. Moreover it was argued that pay packages should contain long-term perspectives and claw back provisions.

With respect to shareholders vote on remuneration, most participants favoured a vote on the remuneration policy and the remuneration report. Few participants suggested also a vote on the individual remuneration. Certain pointed to two tier systems and stated that these systems will have problems with binding shareholder votes on remuneration as this will challenge the power of the supervisory board. Others saw a risk of increasing short-termism by giving more voting rights to possibly short-term orientated shareholders.

f) Cross border / Electronic voting

With respect to cross border voting, a lot of participants criticised that there are still financial and jurisdictional impediments to cross border voting (e.g. special power of attorney). Some participants stated that in spite of the shareholders rights directive, you can still find share blocking in some Member States.

Others stated that electronic voting remains an important issue and is still not working properly. It was argued that many barriers (also regulatory) must be removed. Moreover some participants expressed their concerns about empty voting.

Annex V. Main findings of the external Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States

The study on monitoring and enforcement systems of Member States' Corporate Governance codes published in end of September 2009 has for objective to examine the existing monitoring and enforcement mechanisms in Member States and to evaluate their efficiency³⁴⁸. It provides an overview of the legal frameworks of 18 Member States. The study revealed important shortcomings in applying 'comply or explain' principle that reduces the efficiency of the EU's corporate governance framework and hinders the system's usefulness.

The 'comply-or-explain' approach enjoys broad support from regulators, companies and investors. However, its practical implementation suffers some deficiencies, which affect its proper functioning. According to the study the main reasons are the unsatisfactory level and quality of information on deviations by companies and a low level of shareholder monitoring. The study showed that in over 60% of cases where companies chose not to apply recommendations, they did not provide sufficient explanation. They either simply stated that they had departed from a recommendation without any further explanation, or provided only a general explanation without reference to the company specificity or just a limited explanation³⁴⁹. This view is supported by the institutional investors' assessment of companies' disclosure. Only a quarter of investors consider the quality as being satisfactory³⁵⁰.

Moreover, the study points out to the fact that the level of activity of institutional investors is quite divergent³⁵¹. The general observation is that the institutional investor community consists of a small active minority and majority of passive investors. The majority of respondents feel that shareholders rights need enhancement in two areas: the vote on remuneration statements and the vote on corporate governance statements. The general perception is that enhancement is required not only for shareholder rights but also for shareholder responsibilities. Over 60% of respondents share the opinion that there should be a requirement to report on the implementation of corporate governance policy³⁵².

The study suggests that the functioning of the 'comply or explain' can be improved by the existence of a genuine obligation to comply or explain with a higher level of transparency and qualitative and comprehensive disclosure of information. The information serves as material for monitors and enforcers to analyse and take appropriate actions. Furthermore, the issues could be remedied by strengthening the role of market-wide monitors and statutory auditors, and by developing a comply-or-explain regime for institutional investors. Moreover, the study underlines the importance of shareholders exercising their monitoring and enforcement responsibilities. It is suggested that general meetings should become a forum where corporate governance practices would be systematically discussed. In addition to this, significant improvements could be realised by ensuring that shareholders effectively use the rights which they have been provided.

The study concludes that the 'comply or explain' approach should not be abandoned. However its effectiveness should be improved.

³⁴⁸ Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States, available at http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf

³⁴⁹ Page 83 of the study

³⁵⁰ Page 155

³⁵¹ Page 153, 174

³⁵² Page 164 of the study

Annex VI. Overview of situation in MemberStates

1. NATIONAL INITIATIVES AIMING AT ENHANCING THE QUALITY OF CORPORATE GOVERNANCE REPORTING

Finland:

The Securities Markets Association issued on 20 January 2012 guidelines on explanations that companies should provide³⁵³. It recommends in particular that an explanation shall specify what recommendation it departs from (number and heading of the recommendation), explain in what manner it departs from said recommendation, provide an explanation for the departure, and present the solution that the company has adopted instead.

Belgium:

The Corporate Governance Committee commissioned an independent study on the quality of explanation and, on the basis of the findings of this study, issued a number of practical recommendations in 2012³⁵⁴. In particular, reasons for deviations must always comply with both their underlying principle and the spirit of the Code, they must relate to the company's defining features and situation (e.g. with regard to its sector, size, structure, international character, etc.) and specify how these features justify the deviation in question and they must be sufficiently detailed and provide a clear enough idea of the justification for the deviation, so that the recipients can assess the impact of the information they are given. Temporary deviations must specify why they will be temporary, when this temporary situation will end and, where appropriate, whether the company has now fulfilled the provisions of the Code.

UK:

The Financial Reporting Council launched in December 2011 a discussion between companies and investors on what constitutes an appropriate explanation and introduced guidelines on the 'comply or explain approach' in the Corporate Governance Code³⁵⁵. According to the code, in providing an explanation, the company should aim to illustrate how its actual practices are consistent with the principle to which the particular provision relates, contribute to good governance and promote delivery of business objectives. It should set out the background, provide a clear rationale for the action it is taking, and describe any mitigating actions taken to address any additional risk and maintain conformity with the relevant principle. Where deviation from a particular provision is intended to be limited in time, the explanation should indicate when the company expects to conform with the provision.

Greece:

In addition, also the Hellenic Corporate Governance Council is planning to provide more guidance on the quality of explanations.

2. NATIONAL RULES ON DIRECTORS' REMUNERATION

Austria

³⁵³ See http://cgfinland.fi/files/2012/01/Guideline_comply-or-explain_en.pdf

³⁵⁴ See <http://www.corporategovernancecommittee.be/en/tools/explain/>

³⁵⁵ See <http://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx>

Austrian stock corporations are organised in a two tier-system. The remuneration of the supervisory board is a matter to be decided on by the shareholders, either generally in the articles of association or by a binding vote of the general meeting.

The remuneration of the management board is determined by the supervisory board. This remuneration should be in line with the principles set by the Stock Corporation Act: the total remuneration of the members of the management board must be commensurate with the tasks and performance of each individual member of the management board, the situation of the company, the usual level of remuneration, and must also create incentives to promote the long-term development of the company.

Section 243b of the Austrian Commercial Code, requires stock corporations listed on a regulated market to draw up a corporate governance report every year, containing inter alia the total remuneration of each member of the management board as well as the principles of the company's remuneration policy. The total remuneration of the management board for a business year must be reported in the notes to the financial statements.

Additionally the Austrian Corporate Governance Code requires the chairperson of the supervisory board to inform the general meeting once a year of the principles of the remuneration system.

Finland

The Finnish Companies Act mandates that the general meeting of shareholders votes, as regards remuneration, on: a) any remuneration payable to the board of directors and to the supervisory board, if any (ch. 5 s. 3) and b) all equity –based instruments entitling to the company's shares (ch. 9 s. 1–3) including when such financial instruments are issued as remuneration.

Under the Finnish Company law, the Board of Directors takes decisions regarding management remuneration and generally on the remuneration payable in the company. However, the Finnish Companies Act (ch. 6 s. 7) allows the Board of Directors to submit a specific matter for the approval of the general meeting of shareholders, including remuneration matters. This approach has never been used to date by the Finnish listed companies.

As far as transparency is concerned the accounting law includes provision on the obligation to disclose information on the total remuneration paid to the managing director (CEO) and in the total remuneration paid to the board of directors, in the notes to financial statements and the annual report.

Furthermore, the Finnish Corporate Governance Code for Listed Companies ("Code"), recommendation 47, recommends that the company shall make available on its website ahead of the annual general meeting of shareholders a remuneration statement. According to the Code, only the information on the CEO is indicated per person. Remuneration paid to the board of directors and supervisory board are disclosed per organ. In addition, the statement includes the main principles and decision-making processes regarding the remuneration of executive directors, including long-term incentive plans, the proportion of their variable remuneration and pension schemes.

France

Currently, in France there is no general vote on the remuneration policy, report or on individual remuneration. However, under the Commercial Code the annual general meeting has the right to

votes on specific issues: a) to determine the total value of the manager's attendance fees (article L. 225-45 paragraph 1 of the code of commerce); b) to allow the Board to grant stock options (article L. 225-185 paragraph 4 of the code of commerce) or the attribution of bonus shares (articles L. 225-197-1-II of the code of commerce) to corporate officers; c) in listed companies, to approve all deferred payments such as termination payments, pension schemes etc. (articles L.225-42-1 and L. 225-90-1 of the code of commerce).

Concerning transparency, in the code of commerce there is no obligation to present to shareholders the remuneration policy. However, there are several measures that grant transparency. In limited companies the report to the general meeting has to: a) take into account the total remuneration (including variable remuneration, bonuses etc) of all corporate officers; b) analyse the fix, variable and exceptional elements of remuneration of corporate officers and describe the methods for their calculation (article L. 225-102-1 of the code of commerce). Furthermore, the chairman of the board of directors writes a report describing the remuneration granted to corporate officers (articles L. 225-37 paragraph 5 and L. 225-68 paragraph 7 of the code of commerce). This report must be approved by the board and disclosed to the public.

The AMF (L'Autorité des marchés financiers) issued a recommendation including an advised format for the transparency of remuneration.

The AFEP-MEDEF code comprises several recommendations concerning the transparency of remuneration. Between them, it is advised to devote a separate chapter for remuneration in the annual report. In June 2013 this Code has been revised and now contains the recommendation to have an advisory shareholder vote on the remuneration report.

Germany

The Aktiengesetz § 120(4) [Companies Act] (AktG) provides for the general meeting of a listed company (public limited company) to have an advisory vote on the remuneration system for management board members. However, this vote is not mandatory, since this item should only be put on the agenda on request of at least 20% of the shareholders.

The Commercial Code (HGB) § 289(5) No 9 requires detailed total remuneration disclosure to be annexed to the annual financial statement for each category of person with regard to the members of the management body, supervisory board, advisory board or similar body.

The German system sets also rules for the disclosure of individual remuneration of directors. In the Handelsgesetzbuch (Commercial Code) § 285(9) individual remuneration transparency requirements are applicable to corporations and big partnership and listed public limited companies for each member of the management board. However, the disclosure is not required if so decided by a majority of the general meeting representing at least three quarters of share capital.

Finally, the Deutsche Kodex für gute Unternehmensführung [German Corporate Governance Code] (DCGK) contains a number of relevant provisions requiring a detailed disclosure of individual remuneration of the members of the management board. Under paragraph 5.4.6, the remuneration of supervisory board members is decided by the general meeting or set out in the articles of association. It should reflect the responsibilities and scope of activities of the supervisory board members, as well as the company's economic situation and performance.

Italy

In the Italian system, shareholders have an advisory vote on remuneration policy. However, industry regulation applying to banks and insurance companies mandates binding shareholder approval of remuneration policy.

As far as transparency on remuneration is concerned, Art. 123-ter of TUF (Consolidated Law on Financial Intermediation), contains provisions regarding the report on remuneration. Listed companies must publish a report on remuneration available before the general meeting; this report is approved by the Board of Directors.

The precise and analytic content of the remuneration report has been detailed by the Consob deliberation No.18049 of 23 December 2011. The report must include two sections. The first one includes a precise description of the company's policy on the remuneration of the members of the board, general managers and executives with strategic responsibilities and the procedures used to adopt and implement this policy. The criteria of the policy have been envisaged by the Code of Corporate Governance.

The second section, which is intended for the members of the board and auditing bodies, discloses total individual remuneration. For companies different from small companies, the illustration of the remuneration is individual also for some executives with strategic responsibilities limited to those whose pay is higher than that of the chief executive director (while for small companies the illustration is aggregate).

Lithuania

Currently, in the Lithuanian legal system does not include transparency requirement on remuneration.

Furthermore, there is no obligation to hold a vote on remuneration even if the Corporate Governance Code recommends that "The general shareholders' meeting should approve the amount of remuneration". However, there is a proposal, still pending approval, to amend the Law on Companies of Lithuania to give shareholders a binding vote on the conditions (including remuneration) of the civil agreement which will be signed by directors.

The Netherlands

Dutch limited companies (NVs) must have remuneration policy established by their general meeting. The remuneration of individual directors is established by supervisory board following the recommendation of the remuneration committee. Individual remuneration must in any case be in line with the remuneration policy (Article 2:135 of the Civil Code).

As far as transparency is concerned, Dutch limited companies (NVs) must, in their annual accounts, state the remuneration of each member of the management board and of the supervisory board. The pay of members of the management board must be broken down into a) regular pay, b) pay receivable in the long term, c) pay receivable upon termination of employment, d) profit-sharing and bonuses. The annual report must mention the remuneration policy and how this policy was implemented in practice during the reporting year (Article 2:391 of the Civil Code). The remuneration report is placed on the company website (Principle II.2 and best practice provisions II.2.10 to II.2.15).

Poland

The Polish Commercial Companies Code Article 392(1) and (2), gives shareholders the rights to decide on the remunerations which may be granted to members of the supervisory board, unless otherwise provided in the articles of association. No other vote on remuneration is granted to shareholders. Under Article 378(1) CCC, the remuneration of management board members is determined by the supervisory board, unless the articles of association provide otherwise.

Remuneration policy issues in listed companies are regulated in Poland by the provisions of the Finance Minister's Order of 19 February 2009 on current and periodic information provided by issuers of securities and conditions for recognising information required by the law of a non-EU member state as equivalent and the 'Code of Best Practice for WSE Listed Companies'. In particular, according to Section I.5 of the 'Code of Best Practice for WSE Listed Companies', a company should have a remuneration policy and rules for defining this policy. The remuneration policy should determine the form, structure, and level of remuneration of members of supervisory and management bodies.

Concerning disclosure requirements, members of the management and supervisory bodies of public companies are required to disclose their salaries, bonuses and benefits according to Article 68a of the Act of 29 July 2005 on public offer(s) and conditions for admitting financial instruments to the regulated system of trading, and on public companies. Similarly, article 91(5)(17) of the aforementioned Order of the Minister of Finance requires issuers to disclose in the account annual report of the activities of the management board the total amount of salaries, bonuses and benefits paid, payable or potentially payable to each individual member of managing and supervising bodies.

Spain

Law 2/2011 includes, for the first time, the obligation for listed companies and saving banks to elaborate an annual report on the remuneration of directors. This report must include: a) complete information regarding the remuneration policy of the Board of Directors for the year in course and the coming years together with a reference to the implementation of the remuneration policy during the past year and b) information in respect of the individual remuneration accrued for any of the Directors. This according to article 61ter paragraph 4 the report on Directors' remuneration must be submitted to the advisory vote of the General Assembly.

The unified Good Governance Code of listed Companies (recommendation 8) states that is the Board of Director responsible to decide on director's remuneration. Following recommendation 35 the company's remuneration policy must specify in details the fixed and the variable components.

Concerning transparency on remuneration, according to article 27 of the Law 2/2011 remuneration policies of listed companies must be disclosed in relation to the remuneration of directors, either executives or non-executives (the remuneration report). Furthermore, the final provisions of the Law 2/2011 include information on the identity and remuneration of the directors in the annual corporate governance report.

Slovakia

With respect to the right to vote on remuneration policy, the relevant regulation is contained in provisions of Art. 187 (1) point i) of the Slovakian Commercial Code, which provides that, the powers of the general meeting include: a) approving individual annual financial statements and

individual extraordinary financial statements, deciding in the distribution of profit or payment of losses, and determining director's fees and b) approving the rules for remunerating members of the company's bodies, unless the articles of association determine that such remuneration rules are to be approved by the supervisory board.

Furthermore, the Corporate Governance Code states that shareholders should have the opportunity to participate effectively in decisions concerning the remuneration of board members and key executives. The Corporate Governance Code advises to disclose in details both remuneration policy and individual remuneration of the members of the company's bodies.

Sweden

In Sweden there is a distinction between remuneration to Board members, which are all non-executives, and remuneration to the executive management. Remuneration to Board members for Board work is resolved upon, individually, by the AGM for each Board member. Remuneration to management (the CEO, other person in management), is resolved upon by the Board.

The Companies Act requires an AGM vote on a remuneration policy. The remuneration policy should cover all compensation, including salaries, variable compensation and incentive programs. The AGM vote is binding. It is possible to deviate from the remuneration policy only if the resolution allows a deviation or in special unpredictable circumstances.

Concerning transparency, according to the Annual Accounts Act, the Annual report should contain the previous year's Remuneration policy, as well as the proposed new policy. The auditors are required to produce a written statement to the Board on the correct application of the previous year policy. This statement should be made public to the shareholders not later than three weeks ahead of the AGM.

United Kingdom

At present, the Companies Act requires shareholders to be given an advisory vote on the remuneration report (DRR) published as part of the annual reporting cycle. Under Section 217, the Companies Act 2006 also requires that all companies must seek shareholder approval for compensation payments to directors for loss of office. However, this applies only to payments made over and above that which the director is contractually entitled to.

The UK Government is currently proposing to introduce new requirements through the Enterprise and Regulatory Reform Bill. The proposed legislation requires companies to produce a two part remuneration report, with the first part setting out the forward-looking remuneration policy ("the policy statement") and the second part setting out what remuneration executive directors received in the previous year ("the implementation report").

Shareholders will get a binding vote on the directors' remuneration policy report. Companies will be able to choose how frequently to put the remuneration policy to a shareholder vote but must do so as a minimum every three years. However, if a company wishes to make any changes to the remuneration policy it will have to re-present it to shareholders for approval.

Companies will also have to produce an annual implementation report that includes a single figure for the total pay directors received that year. Shareholders will get an annual advisory vote on the implementation report. If a company fails the annual advisory vote (i.e. if it is rejected by the majority of those voting), in a year in which the remuneration policy has not been put to

shareholders, the company have to re-present their remuneration policy to shareholders the following year.

Finally, to improve transparency around loss of office payments, companies will need to promptly publish a statement setting out the exact payments the director has received or may receive in future. Companies will not be able to pay more than shareholders have agreed.

As regards non-executive directors, the Corporate Governance Code currently states that “the board itself, or if required by the Articles of Association, the shareholders should determine their remuneration” and the shareholder approval should be sought in advance if non-executive directors are to be given share options or other performance-related remuneration.

As far as transparency is concerned, the law provides that all UK registered companies must include information about directors’ remuneration in the notes to their accounts. The extent to which companies have to disclose details of directors’ remuneration depends on the size and nature of the company.

Finally, as far as Financial Services is concerned the Financial Services Authority (FSA) issued a Remuneration Code. Among other measures, it gives shareholders a binding vote on directors’ pay.

5. NATIONAL RULES ON RELATED PARTY TRANSACTIONS

Italy

According to relevant legislation (Civil Code, Consolidated Law on Financial Intermediation) and regulations from the Government regulation Authority (Consob), material RPTs must be submitted to a Committee of independent directors which must receive all relevant information and issues a binding opinion on the transaction. The committee can seek an advice of an independent expert of its choice at the expense of the company.

Material RPTs must also be approved by decision of the Board of Directors. The interested parties are not excluded from the vote, but they must disclose theirs interests in the transaction. In case of negative opinion of the Committee of independent directors, the transaction still could be approved *ex ante* at the shareholders' meeting. Interested parties are again not excluded from the vote. Moreover, companies must provide adequate information on individual material RPTs by issuing (within 7 days) a circular describing the transaction while also enclosing the independent committee opinion.

UK

Rules on related party transactions are provided in the Companies Act 2006, which applies to all companies and in the UK Listing Rules for companies with premium listings. In case of smaller RPTs (less than 5% but more than 0,25% of the assets) listed companies must provide a confirmation of an independent advisor. However, a decision of the Supervisory Board is not required. Shareholders hold a right of approval if the transaction represents more than 5% of the assets. The approval is required before the entering or the completion of the transaction. The interested parties are excluded from the vote.

Finland

Provisions on RPTs are included in the Finnish Companies Act. The opinion from an independent advisor is not required; however the Board of Directors may request advice from an independent advice as a prudent measure. All transactions, even non material, are subject to the approval of the Board of Directors, with the related party not participating in the decision. There is no requirement of ex ante shareholder approval for most important transactions.

France

Rules on related party transactions are set up in the French Code de commerce. RPTs which are not concluded at normal market conditions are subject to ex ante approval by the board, with the related party being precluded from voting. A special report by the company's auditor must be established and disclosed to shareholders. The general meeting, with the related party not participating in voting, gives an *ex post* approval of RPTs. If no approval is granted, the liability of the board members can be engaged.

5. NATIONAL RULES ON PROXY ADVISORS

UK:

Proxy advisors are not subject to any direct regulatory provisions or guidance and disclosure is not required from proxy advisors themselves. However the UK Stewardship Code³⁵⁶, which is addressed to institutional investors, applies to proxy advisors by extension. Institutional investors are not permitted to delegate responsibility for stewardship. In addition they are required to disclose the use they have made of proxy voting or proxy advisory services. They must describe the scope of such services, identify the provider, and the extent they rely upon the advice. Currently, there are no provisions imposing the alignment of the end owners' interests and the proxy advisors' interests. Nevertheless, the Stewardship Code encourages this alignment.

France:

The AMF, the Financial Markets Authority, issued a recommendation on proxy advisors promoting transparency in the establishment and execution of voting policies and recommending the establishment of appropriate rules on the management of conflicts of interests³⁵⁷.

Netherlands:

There are no specific rules regarding proxy advisors. According to Code of best practice shareholders using proxy advisors are expected to form their own judgement on the voting practice and advice of the advisor.

Finland:

There are no legislative or regulatory provisions regarding proxy advisors in Finland other than the general provisions of civil law (obligation to act with due care and accountability to the client). However, if a bank or investment firm provide proxy service, the provider is subjected to the sector regulatory framework, including the conflicts of interest.

³⁵⁶ See <http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-September-2012.aspx>

³⁵⁷ See AMF Recommendation No. 2011-06 of 18 March 2011 on proxy advisory firms (EN version), at: http://www.amf-france.org/documents/general/9915_1.pdf

5. NATIONAL RULES ON TRANSPARENCY OF INSTITUTIONAL INVESTORS AND ASSET MANAGER AS REGARDS VOTING AND ENGAGEMENT

UK:

The UK Financial Reporting Council's Stewardship Code³⁵⁸ sets out good practice for institutional investors on the monitoring of and engagement with the companies in which they invest. The principles of this Code make clear that institutional investors should disclose their engagement policy and voting records. The Financial Services Authority requires UK asset managers to produce a statement of commitment to the Code or to explain why it is not appropriate to their business model.

Sweden

The Act on national pension funds³⁵⁹ requires the 4 national AP funds to issue internal voting policy guidelines. There is no obligation to publish it.

The Swedish Investment Fund Association's Code³⁶⁰ for fund managers recommends the disclosure of voting policies.

Germany

The voluntary code of conduct of the German Association for Investment and Asset Management³⁶¹ seeks to establish a governance framework for the industry. When performing its functions, the investment company (KAG) acts exclusively in the interest of the investors and the integrity of the market.

The investment company must establish procedures which are suitable to identify circumstances giving rise to conflicts of interest; and to resolve such conflicts paying due regard to the protection of the interests of the investors and/or investment undertakings. Of particular importance, for the funds managed by a company, there will be suitable procedures to avoid excessive transactions costs as a result of inter alia, excessive turnover. Transactions which merely serve to generate additional fees are not permissible.

The supervisory board and management of the investment company will work towards good corporate governance on the investment company. The two boards may not pursue their own interests and the supervisory board will ensure that the management have appropriate risk management and control.

The investment company informs the investors about its voting policy.

Finland

Act on common funds³⁶² requires the disclosure of voting policies in the fund prospectus. The fund management company is to disclose in its half-year annual report how it has used the voting

³⁵⁸ See <http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-September-2012.aspx>

³⁵⁹ See http://www.ap3.se/sites/english/SiteCollectionDocuments/About_us/ENG_Pension_Funds_Act.pdf

³⁶⁰ See <http://fondbolagen.episerverhosting.com/en/Regulations/Guidelines/Code-of-conduct/>

³⁶¹ See http://www.bvi.de/fileadmin/user_upload/Regulierung/Wohlverhaltensregeln.pdf

³⁶² See <http://www.finlex.fi/en/laki/kaannokset/1999/en19990048.pdf>

rights. Disclosure is also required if a fund holds more than 5 % of the total voting rights, if this policy deviated from the general voting policies.

Based on this requirement the Finnish federation of Financial Services has issued guidelines for UCITS³⁶³. The Finnish pension alliance has issued non-binding guidelines on stewardship (2006) and responsible investments (2008)³⁶⁴.

Netherlands:

Dutch institutional investors are obliged to include in their annual report or on their websites a statement about their compliance with the best practice provisions of the Dutch Corporate Governance Code³⁶⁵. The investor that has not applied a best practice provision has to explain why (comply or explain). Principle: Institutional investors shall act primarily in the interests of the ultimate beneficiaries or investors and have a responsibility to the ultimate beneficiaries or investors and the companies in which they invest, to decide in a careful and transparent way, whether they wish to exercise their rights as shareholder of listed companies.

Institutional investors shall publish annually their policy on the exercise of the voting rights for shares they hold in listed companies. They shall report annually, on their website or in their annual report, on how they have implemented their policy on the exercise of the voting rights in the year under review. Institutional investors shall report at least once a quarter on whether and, if so how they have voted at shareholder meetings.

France:

In line with the EU UCITS rules, the French Financial Market Authority has issued rules regarding the obligations of UCITS to provide their investors with their voting policy³⁶⁶. The French asset management association has issued guidelines about the implementation of these rules³⁶⁷ and a transparency Code for funds specialized in responsible investing.

³⁶³ See Finnish Federation of Financial Services website: www.fkl.fi

³⁶⁴ See Finnish Pension Alliance (TELA) website: www.tela.fi.

³⁶⁵ See <http://commissiecorporategovernance.nl/dutch-corporate-governance-code>

³⁶⁶ See Article 314-100 of the General Regulation of the Autorité des Marchés Financiers, at: http://www.amf-france.org/documents/general/7553_1.pdf

³⁶⁷ See http://www.afg.asso.fr/index.php?option=com_content&view=article&id=98&Itemid=87&lang=en

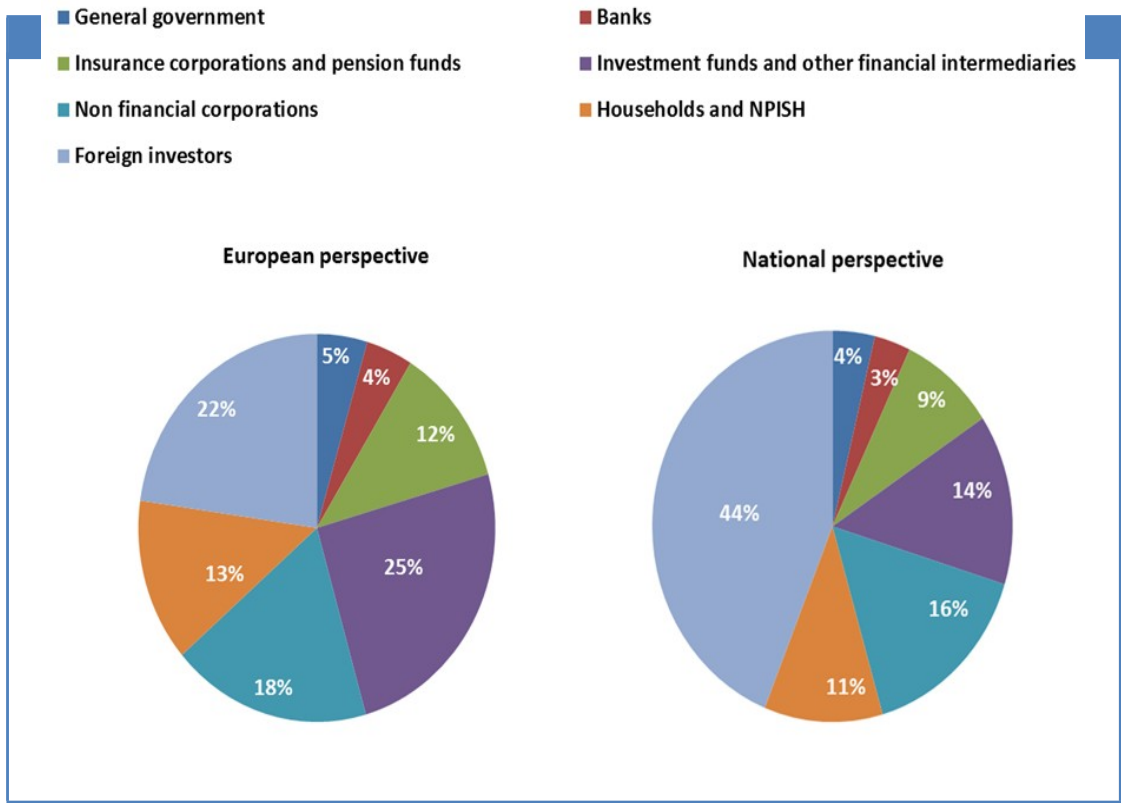
Annex VII. Additional information on policy context, problems and drivers

*Figure 1: Listed Companies in the EU Member States and market capitalization in 2012)*³⁶⁸

Member State	Market Capitalization (Mio. EUR)	Total number of domestic listed companies.
UK	2,355,184	2,179
France	1,422,204	862
Germany	1,159,325	665
Spain	776,174	3,167
Netherlands	507,784	105
Sweden	437,210	332
Italy	347,753	297
Belgium	234,045	154
Denmark	175,387	174
Poland	138,629	844
Finland	123,775	119
Ireland	85,030	42
Austria	82,708	70
Luxembourg	54,864	29
Portugal	51,113	46
Greece	34,775	267
Czech Republic	28,987	17
Croatia	16,816	184
Hungary	16,442	51
Romania	12,421	77
Bulgaria	5,199	387
Slovenia	5,050	61
Slovak Republic	3,596	69
Lithuania	3,091	33
Malta	2,832	20
Estonia	1,818	16
Cyprus	1,556	111
Latvia	869	31
Total Amount in the EU	8,084,637	10,409

³⁶⁸ See <http://wdi.worldbank.org/table/5.4#>.

Figure 2: The ownership structure of EU listed companies in 2011³⁶⁹



³⁶⁹ Observatoire de l'épargne européenne- OEE, INSEAD OEE Data services, Who owns the European economy? Evolution of the ownership of EU-listed companies between 1970 and 2012, August 2012, page 7.

Figure 3: Participation of institutional investors in European companies

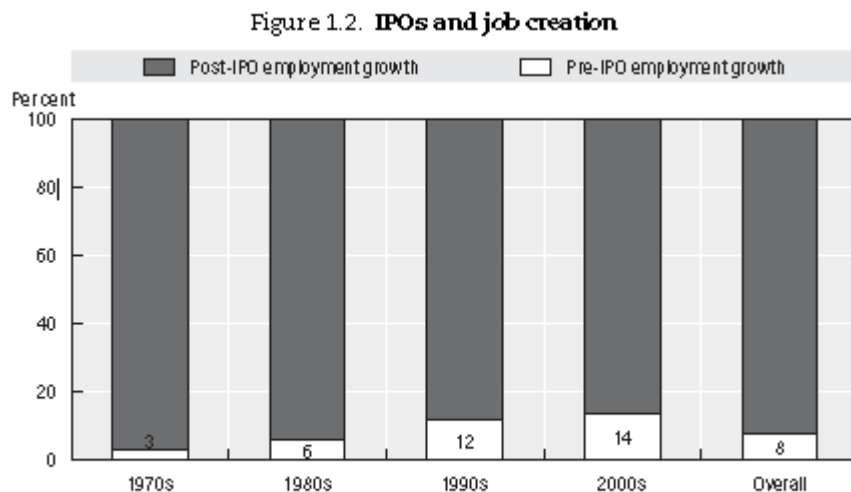
country	Market cap. (\$ bln)	Total Inst. (%)	by nationality				by flow
			Foreign Inst. (%)		Domestic Inst. (%)		
			Foreign U.S. Inst. (%)	Foreign non-U.S. Inst. (%)			
quarter	201012	11					
US	15,525	72.6	8.3	0.0	8.3	64.3	
CN	4,580	11.8	8.0	3.1	4.9	3.8	
JP	4,031	13.6	9.6	5.7	3.9	4.1	
GB	1,946	30.1	18.0	11.0	7.0	12.2	
CA	1,919	50.2	21.6	17.0	4.6	28.6	
FR	1,768	22.3	17.3	7.8	9.5	5.0	
IN	1,620	13.9	10.1	4.5	5.6	3.8	
AU	1,584	15.9	13.7	6.5	7.3	2.1	
HK	1,526	14.4	11.7	6.3	5.4	2.7	
BR	1,461	25.1	20.9	11.7	9.2	4.2	
DE	1,377	26.1	20.4	8.1	12.3	5.7	
CH	1,208	28.1	23.2	12.8	10.4	4.9	
KR	1,066	14.7	14.6	7.4	7.2	0.1	
RU	994	9.4	9.3	3.1	6.2	0.0	
TW	892	16.7	15.1	7.8	7.3	1.6	
ES	633	15.7	14.3	5.4	8.9	1.4	
SE	586	37.6	13.7	6.2	7.5	23.9	
IT	561	15.0	13.8	4.7	9.1	1.2	
ZA	538	20.7	16.2	10.4	5.8	4.5	
NL	518	35.9	33.2	18.8	14.4	2.7	
SG	494	15.8	13.5	8.2	5.3	2.3	
MX	436	23.7	21.7	14.7	7.1	2.0	
MY	401	7.9	7.1	3.4	3.7	0.8	
ID	362	10.7	10.7	4.7	6.1	0.0	
SA	358	0.2	0.1	0.0	0.1	0.1	
CL	334	5.7	5.3	3.3	2.0	0.4	
TR	304	11.7	11.6	5.2	6.4	0.1	
TH	278	13.0	11.1	4.2	6.9	1.9	
NO	261	23.3	12.9	5.1	7.9	10.4	
BE	253	16.6	15.2	7.1	8.1	1.4	
DK	228	23.6	20.1	10.4	9.6	3.5	
IL	222	23.1	21.9	17.7	4.2	1.2	
FI	210	30.0	20.2	7.2	12.9	9.8	
CO	188	1.3	1.2	0.6	0.6	0.1	
PL	171	21.2	7.5	3.0	4.4	13.8	
LU	161	14.9	24.7	10.6	14.2	0.2	
PH	151	8.1	8.1	4.3	3.8	0.0	
BW	147	42.0	42.0	32.5	9.6	0.0	
AT	126	17.3	15.5	6.5	9.0	1.8	
QA	124	0.8	0.8	0.2	0.6	0.0	
KW	119	0.7	0.4	0.2	0.2	0.4	
AE	116	1.9	1.7	0.6	1.1	0.1	
PE	97	14.5	14.5	7.3	7.2	0.0	
IE	92	47.5	46.9	30.2	16.7	0.6	
PT	88	12.2	11.3	3.4	7.9	1.0	
GR	75	12.0	11.7	7.0	4.7	0.3	
EG	74	8.3	8.2	4.5	3.7	0.1	
MA	68	0.6	0.6	0.4	0.2	0.1	
AR	58	9.4	9.3	7.6	1.7	0.1	
CZ	43	13.9	13.3	7.9	5.5	0.5	
NZ	38	10.9	7.0	3.9	3.2	3.9	
VN	37	3.1	1.9	0.8	1.1	1.2	
PK	35	5.9	2.7	1.4	1.3	3.2	
JO	31	0.3	0.3	0.2	0.1	0.0	
HU	28	14.2	23.4	9.4	15.0	0.7	
OM	20	1.2	1.0	0.4	0.6	0.2	
CZ	19	7.0	6.8	2.5	4.3	0.2	
LC	17	5.9	5.9	2.8	3.0	0.0	
BH	16	0.1	0.1	0.0	0.1	0.0	
RO	14	5.9	2.2	1.3	0.9	3.6	
UA	13	8.1	8.1	1.9	6.2	0.0	
KE	12	1.7	1.7	0.6	1.1	0.0	
HR	11	1.5	1.2	0.4	0.8	0.3	
Grand Total	51,708	1342.5	1017.9	572.6	493.3	236.0	

Source: Factsets Lionshares 2013

Figure 4: Engagement and voting strategies by country (Source: Eurosif)

€Mn	Engagement/Voting		CAGR
Country	2009	2011	2009-11
Austria	€ 963	€ 1,191	11.2%
Belgium	€ 20,371	€ 19,586	-1.9%
Denmark	€ 41,792	€ 187,718	111.9%
Finland	€ 31,551	€ 44,870	19.3%
France	nm	nm	nc
Germany	€ 9,190	€ 7,927	-7.1%
Italy	€ 317	€ 18,531	664.1%
Netherlands	€ 307,487	€ 472,019	23.9%
Norway	€ 195,200	€ 55,652	-46.6%
Poland	€ 0	€ 0	nc
Spain	€ 3,112	€ 11,094	88.8%
Sweden	€ 118,760	€ 137,660	7.7%
Switzerland	€ 3,461	€ 4,946	19.5%
UK	€ 936,269	€ 989,211	2.8%
Europe	€ 1,668,473	€ 1,950,406	8.1%

Figure 5: IPOs and job creation



Source: "VentureImpact" 2007, 2008, 2009 and 2010 by HBS Global Insight and IPO Task Force, August 2011, CEO Survey cited in "Rebuilding the IPO On-Ramp", IPO Task Force, 2011.

Annex VIII. Details on administrative burden

The estimates of the administrative burden presented relate to the proposed package of options. While certain of these costs would be imposed on listed companies, others would be borne by institutional investors, asset managers and proxy advisors. All estimations are based on the available public data, as well as on evidence gathered by the Commission (during consultations and meetings with stakeholders³⁷⁰). The exact costs will depend on the precise content of the requirements, as well as on how the concerned stakeholders choose to disclose relevant information. Therefore, and due to the qualitative nature of the measures potentially to be implemented, all the figures provided should be considered as estimates and a fair amount of uncertainty needs to be included in the numbers provided. Moreover, this annex does not take account of the benefits potentially stemming from the proposed measures.

Transparency of institutional investors and asset managers on their voting and engagement and certain aspects of asset management mandates

The preferred option would entail some administrative burdens for institutional investors and asset managers. These costs would be linked to publication of the voting and engagement policy of institutional investors as well as of a narrative report on past engagement and voting records. In addition the preferred option would require asset owners to disclose how they incentivise their asset managers (in asset management mandates, regarding issues such as shareholder engagement, performance evaluation, expected levels of portfolio turnover, stock-lending, etc.) to act in the best interest of their final beneficiaries. As regards the asset managers, the preferred option would require them to disclose information on portfolio concentration, portfolio turnover, actual and estimated cost of portfolio turnover and whether the level of portfolio turnover is in line with the agreed investment strategy.

The costs of publication of engagement and voting policies and information on the main features of asset management mandates should not be substantial, as this would entail only publication of a statement on the policies adopted by the concerned institution and making public already available information. In line with previous Commission estimation, the cost of preparing such publications would range between 600 and 1000 euros per year.³⁷¹ Moreover, as estimated above a website publication costs approximately € 70. It should however also be noted that normally such costs are mostly incurred in the first year and much less costs in further years, since such policies and mandates do not change each year.

Similarly, the administrative burden related to disclosure by asset managers of information on portfolio concentration, portfolio turnover, actual and estimated cost of portfolio turnover and whether the level of portfolio turnover is in line with the agreed investment strategy should be rather limited. First of all, the information is already available to asset managers, but has to be prepared for disclosure. Moreover, EU legislation already requires, for some asset managers, to disclose information on investment strategies and costs.

In addition, it should be noted that some asset owners and asset managers already publish information regarding voting and engagement policy and voting records, as they sign up to self-

³⁷⁰ See Annex III and IV.

³⁷¹ See to this effect CRD IV Impact Assessment, Administrative burden for credit institutions and supervisors, http://ec.europa.eu/internal_market/bank/docs/regcapital/CRD4_reform/IA_directive_en.pdf

regulatory codes, or because they are required by law to do so.³⁷² In a few markets, publication of such information is considered to be best practice already.

More substantial costs could be linked with the publication of voting records and past engagement. This would however largely depend on the level of details required, as a detailed report would be more costly than a report in an aggregated form.

One Dutch institutional investor estimates that the annual total costs for a large institutional investor with over 2000 investee companies in the portfolio for the publication of a detailed report (votes per company and per agenda item; all general meetings and disclosing reasons for voting against management proposals) are between € 15.000 and € 20.000. According to the same source, costs would be significantly lower (approx. € 500) if institutional investors are required to draft and disclose an aggregated overview of their voting behaviour (number of general meetings attended, % against management proposals and some 'highlights' (e.g. remuneration). Total costs for an institutional investor with concentrated holdings (approx. 80), disclosing the detailed voting behaviour would also amount to approx. € 500. One of the biggest international asset managers also estimated that if only aggregated voting record is required, without the requirement for an external audit, then the cost would be extremely limited and would represent a few hours of staff time to run the report, check it for accuracy and prepare it for publication on the website³⁷³.

The proposed changes would affect approximately 3200 asset management companies active in the EU.³⁷⁴ The exact number of institutional investors potentially affected is more difficult to determine, due to lack of aggregated information, however, it could be estimated that it could affect approximately 5400 insurance companies³⁷⁵ and 7400 pension funds.³⁷⁶

Remuneration: binding rules on transparency and mandatory shareholder vote

The proposed combination of options would entail certain additional, though limited costs and burdens for listed companies. It would require them to disclose the remuneration policy and the individual remunerations granted to members of the board. It will also require putting the remuneration policy and the remuneration report to a vote by shareholders. The administrative

³⁷² For more details on different markets, see Annex VI.

³⁷³ By comparison, a detailed publication requirement, such as in the US could imply considerable costs. In the US the voting records are to be filed with the SEC according to specific templates and disclosed to shareholders of portfolio companies (Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 68 Fed. Reg. 6564, Feb. 7, 2003). One of the biggest international asset managers estimates that their filing to the US SEC, which has very specific formats and fund groupings, costs them about \$300,000 a year. About \$250,000 of this is data collection and website hosting; about \$50,000 of this cost is for the formatting to SEC requirements and legal sign off by a specialist external firm.

³⁷⁴ Data from end 2011, according to EFAMA, Asset Management in Europe, Facts and Figures 5th Annual Review, 2012, at: <http://www.efama.org/Publications/Statistics/Asset%20Management%20Report/Asset%20Management%20Report%202012.pdf>, page 2.

³⁷⁵ According to InsuranceEurope, in 2011 there were 5456 insurance companies registered in the EU, see: <http://www.insuranceeurope.eu/uploads/Modules/Publications/eif-2013-final.pdf>

³⁷⁶ According to PensionsEurope, in 2010 there were 265 368 pension funds registered in Europe. However, a large number of these are pension funds having less than 100 members, to which Member States may choose not to apply the rules of the IORP directive and that would also not be subject to the rules envisaged in this package. Taking into account the funds having over 100 members, there are currently over 7400 pension funds. See : <http://www.efrp.org/Statistics.aspx>

burdens could be expected to be mostly incurred in the first year and more limited for the following years.

Disclosure remuneration policy

As regards disclosure of the remuneration policy it implies the preparation of a statement which describes the rationale for the policy, how it is prepared and linked to performance and business strategy and how it takes into account the long-term sustainability of the company.

Listed companies either already have such a formal policy or they have it de facto (the contracts with the different board members). Informal consultations would seem to indicate that, depending also on how complicated the policy will be, the preparation for publication of the policy should take approximately 2 to 4 working days depending from the company, the rules currently applied and the policy they have in place.

Considering the different hourly wages in Member States, the cost could range between € 90 to € 180 (Bulgaria) and € 1140 and € 2280 (Luxembourg) per company, with an average cost between € 525 and € 1050. However, it should be noted that in 15 Member States there is already an obligation to disclose remuneration policy. Furthermore, providing information on the remuneration policy is already foreseen in Commission Recommendation 2004/913, which has at least partly been implemented by Member States. Finally, it should be noted that remuneration policies are normally not revised on a yearly basis, which means that costs will be lower after the first year and then only reach the initial level after a more significant revision of remuneration policy.

Disclosure remuneration report

As regards the remuneration report, which involves a disclosure of individual remunerations granted, the preferred option foresees a degree of standardisation of the disclosure. In the first year this will create some adaptation costs, but in further years such a standardisation will facilitate disclosure.

Given that the average European board of directors consists of 12 members³⁷⁷, the processing of the information required for the disclosure should not give rise to considerable burden. In line with previous estimations made by the Commission's services for comparable disclosures³⁷⁸, the preparation of such additional statement in the annual report would range between 600 and 1000 euros per year per company. However, the additional burden flowing from this option would be much lower. Companies are already required to report on the amount of remuneration paid to members of the administrative, managerial and supervisory bodies in the annual accounts.³⁷⁹ Providing information on individual remuneration is also foreseen in the Commission Recommendation 2004/913, which has at least partly been implemented by Member States. 11 Member States already require publication of individual remuneration.

³⁷⁷ "Corporate Governance Report 2011 - Challenging board performance", Heidrick & Struggles, 2011, p. 37

³⁷⁸ See to this effect CRD IV Impact Assessment, Administrative burden for credit institutions and supervisors, http://ec.europa.eu/internal_market/bank/docs/regcapital/CRD4_reform/IA_directive_en.pdf

³⁷⁹ See Art. 17 (1) (d) of the Accounting Directive 2013/34/EU. The Directive allows however Member States not to apply this requirements when the information makes it possible to identify the position of a specific member of such a body.

Say on Pay

The administrative burden linked to a shareholder ‘say on pay’ are due to the organisation of the shareholder vote. As this would in practice imply only adding the discussion and vote on remuneration to the agenda of the general meeting, it has been estimated that an additional vote does not add any cost for the company.³⁸⁰

Related party transactions: improving transparency requirements and shareholders vote on the most important transactions

The preferred options would involve some additional costs for listed companies.

Public announcement

First, the public announcement at the time of the transaction for more important related party transactions would involve some administrative burden. It has been estimated that the cost of disclosing related party transaction for accounting reasons for a company equals to 265 euros.³⁸¹ This administrative burden is already in place and the only relevant change would be that the moment of publication is at an earlier moment. Costs of this would be estimated to add a fraction to the costs of the accounting disclosure, around 50 euro. The publication of this information could be provided via companies’ websites in order to reduce costs. A website publication costs approximately 70 € per company. The disclosure of each substantial related party transaction would therefore cost to a company an estimation of 120 €.

Fairness opinion

Additional administrative burden would also be linked to the requirement to have a fairness opinion on the proposed transaction of an independent expert. Depending on the complexity of the transaction it would seem that an experienced advisor would be able to assess the fairness of the given transaction within between approximately 5 and 10 hours. This could result in a cost of maximum 2500-5000 € in case the opinion is made by an auditor. Moreover, this cost results in line with previous estimation made by the Commission for similar policy actions in a comparable field.³⁸²

Since this transparency would only be required for transactions above a certain threshold (for instance above 1% of assets of the company)³⁸³, only the more important transactions would be covered. Transactions executed on normal market conditions would not be covered. On the basis

³⁸⁰ See also the Impact assessment on Shareholder votes on executive remuneration made by the United Kingdom government, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31374/12-648-shareholder-votes-executive-remuneration-impact-assessment.pdf

³⁸¹ 4th Company Law Directive and IFRS for SMEs, Final Report http://ec.europa.eu/internal_market/accounting/docs/studies/2010_cses_4th_company_law_directive_en.pdf

³⁸² Impact assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts and a Proposal for a Regulation of the European Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities http://ec.europa.eu/internal_market/auditing/docs/reform/impact_assesment_en.pdf

³⁸³ See the Statement of the European Corporate Governance Forum on related party transactions for listed companies, available at http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf_related_party_transactions_en.pdf

of the OECD report³⁸⁴ on related party transactions it would appear that each year some 15% of the listed companies could have one transaction equal or above 1% of their revenue. This would mean that approximately 1550 companies should apply the foreseen rules.

Therefore, the introduction of the transparency requirements on each related party transactions together with the fairness opinion by an external evaluator (auditor) would arise a total maximum costs of 2620 and 5120€. Taking into account that there are approximately 1550 substantial transactions each year, the yearly aggregate cost of the proposed measure for the market results approximately 4,06 and 7,93 million €.

Shareholder vote

A shareholder approval of the most substantial related party transactions could result in some limited administrative burden. In view of the fact that the threshold would be relatively high (for instance 5% of the assets), only a limited number of transactions would be subject to this obligation. As to the potential administrative burden involved, as this would in practice imply only adding the discussion and vote on the RPT to the agenda of the general meeting, no administrative burden would be there. In the case of the organisation of a special shareholder meeting, the costs could of course be more important, in view of the need to convoke and holding the meeting (including venue etc.).

Proxy advisors: binding rules on transparency

The preferred option would involve some administrative burden for proxy advisors, linked with the disclosure of certain key information, such as their policy for the prevention, detection, disclosure and treatment of conflicts of interests and the methodology for the preparation of advice, including in particular the nature of the specific information sources they use and how the local market and, legal and regulatory conditions to which issuers are subject are taken into account.

The additional costs would be linked to improving information on their internal procedures (disclosing methodology and prevention of conflict of interest) and preparing this information for publication. Normally, these costs would essentially be incurred once and only more often if the proxy advisors would change essential parts of these policies.

The preparation of appropriate information on internal procedures would in practice represent a few hours of work of staff. In addition, many proxy advisors already have internal guidelines on the relevant issues and some of them are already, at least partly, publicly disclosed on their websites. Therefore, depending on the proxy advisors and the level of adaptation for publication needed, the additional working hours estimated to prepare the disclosure of the policies will range between 20 and 50. The average hourly wage of senior officials and managers in the country in which proxy advisors are incorporated is approximately 50 €. ³⁸⁵ The cost of preparing the required information for publication will therefore range, for each proxy advisors, between € 1000 and € 2500. As regards the publication, it could take place via websites for an approximate cost of € 70 for proxy advisors'.

³⁸⁴ Related Party Transactions and Minority Shareholder Rights, OECD, 2012 <http://www.oecd.org/corporate/ca/corporategovernanceprinciples/50089215.pdf>

³⁸⁵ These hourly wages are based on standardised ESTAT data (the four-yearly Labour cost survey and the annual updates of labour cost (ALC) statistics) reflecting 2010 figures. They already contain the standard 25% overhead costs, as required by the Standard Cost Model for administrative burden measurement.

There are currently around 10 proxy advisory firms (with 2 main actors sharing most of the market) active in the EU that would be potentially affected by these measures. Total aggregate cost of the measure should therefore range between € 10 700 and € 25 700.

Quality of corporate governance reporting: recommendation providing guidance

The preferred option does not entail any significant costs for listed companies. Under Article 46a of the Directive 78/660/EEC³⁸⁶ listed companies are already required to provide an annual corporate governance statement. This report should provide essential information on the corporate governance arrangements of the company and in particular include the reference to the corporate governance code applied on a 'comply or explain' basis. Under the 'comply or explain' approach, a company which chooses to depart from a corporate governance code recommendation must give detailed, specific and concrete reasons for the departure.

The proposed recommendation would not require companies to prepare a new statement, but only clarify what is the desired quality of explanations. In practice issuers would mainly be encouraged to apply a greater degree of diligence while preparing the statement currently required, but would also know more clearly what is expected of them, which decreases legal uncertainty.

It has been calculated that the whole annual corporate governance statement costs on average to large listed companies €1674.³⁸⁷ However, this administrative burden already exist. In terms of direct costs, the new requirement could only translate in additional few hours of work for the staff preparing the statement in order to increase the level of explanation. Estimation of these costs and of the hours of additional work imposed is made difficult by the case by case improvement needed, which can differ substantially from company to company. However, an external study performed on a sample of companies demonstrates that on average companies would need to provide 5 explanations.³⁸⁸ Considering the total cost of preparing the report, the greater diligence in explaining the reasons not to apply the parts of the code not complied with, will only result in negligible costs.

Finally, it should be noted that the cost will mostly be a one-off cost. Companies will need to adapt their annual corporate governance statement in order to provide better explanation once the measure will be introduced. However, unless significant change in the application of the code by the company occurs, the company will not need to further elaborate or modify its explanation. Therefore, considering the limited cost of the explanation and the insurgence of the cost mostly for the first year, the possible increase of administrative burden would thus be extremely limited.

³⁸⁶ Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies, as amended by the Directive 2006/46/EC.

³⁸⁷ EU project on baseline measurement and reduction of administrative costs http://ec.europa.eu/dgs/secretariat_general/admin_burden/docs/enterprise/files/abst09_cl_data_annex_en.pdf

³⁸⁸ Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States, page 82 http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf

Overview of the cost implications of the proposal:

Increase the level of engagement of institutional investors and asset managers		Create a better link between pay and performance		Transparency and oversight on related party transactions		Transparency of proxy advisors	Improve corporate governance reporting
Transparency of voting policy/ mandates	voting records	Disclosure of the remuneration policy	Remuneration report	Disclosure of each substantial RPT	Opinion of an independent adviser	Disclosure methodology and conflict of interest	Recommendation on guidelines on the quality of corporate governance reports
600 to 1000	Detailed : 15.000 to 20.000 Aggregate: 500	525 and 1050 euro	600 to 1000	120 €	2500-5000 €	1000-2500 €	Negligible estimated additional costs
Total per investor For institutional investors: between 1.100 and 21.000 For asset managers: between 1.000 and 5.000		Total per company Between 525 and 2050 + possible adjustment costs in case of a negative vote at a GM.		Total per company Between 2620 and 5120 + eventual vote to be organized outside an AGM. (OECD estimates that 15% of companies have a RPT annually for a total of 1550 companies)		Total per proxy advisor 1000-2500 €	Total per company Negligible

Specific formula used for the calculation of costs:

Disclosure of remuneration policies: average EU hourly wage for middle management * estimation of hours needed to prepare the document

Opinion of an independent adviser for related party transactions: average EU hourly wage for auditor * estimation of hours needed to prepare the document

Transparency of methodology and conflict of interest for proxy advisors: average EU hourly wage for middle management proxy advisor * estimation of hours needed to prepare the document

Annex IX. Impact on competitiveness of EU companies

Certain of the options included in the proposed package might have an impact, though limited on the competitiveness of European listed companies, as they involve certain additional costs and disclosure of certain sensitive information. Unlisted companies will not be affected. As regards SME, only listed SMEs will be covered and micro-entities will not be affected. No distinction between sectors can be made: the impacts will be the same for all sectors, as the options will apply to all listed companies without distinction.

As regards the costs for companies, it should be noted that most of the costs are likely to be offset by the benefits that companies might draw from the proposal. Certain options might also induce costs not for companies but other stakeholders (institutional investors and proxy advisors).

The impact on the competitiveness of EU companies are depicted below:

Corporate governance reporting

Competitive impacts	Description of impacts		Size and duration of impact	Risks and uncertainty
	Positive	Negative		
Cost and price competitiveness	More guidance on the quality of reports would facilitate the preparation of those	More diligence in the preparation of reports might induce limited additional costs	Very low costs (few hours of staff preparing the report), occurring once a year	none
Capacity to innovate	none	none	n.a.	n.a.
International competitiveness	none	none	n.a.	n.a.

Remuneration

Competitive impacts	Description of impacts		Size and duration of impact	Risks and uncertainty
	Positive	Negative		
Cost and price competitiveness	More oversight by shareholders is likely to induce a stronger link between pay and performance and avoid unjustified transfers of value to the detriment of the company	Disclosure of remuneration policy and of individual remuneration would involve some additional costs, which should be limited, some not significant costs are also linked with the organisation of the shareholder vote.	Costs occurring once a year (publication of remuneration policy and report), plus one-off costs linked to the adaptation to new standardised disclosure requirement	Costs of dealing with consequences of a negative shareholder vote
Capacity to innovate	none	none	n.a.	n.a.
International competitiveness	Positive impact on the sustainability of the company	Possible limited impact due to additional costs.	Possible positive and negative impacts difficult to estimate	Possible positive and negative impacts difficult to estimate

Related party transactions

Competitive impacts	Description of impacts		Size and duration of impact	Risks and uncertainty
	Positive	Negative		
Cost and price competitiveness	Improved oversight would reduce the risk of unjustified transfers of value to the detriment of the company. It would also increase the legal certainty and will reduce the likelihood of court proceedings	Publication of information on more substantial transactions, and especially a fairness opinion by an independent expert could generate additional costs. Organisation of shareholder vote for most substantial transactions can generate additional costs, especially if a special meeting is needed	As only transactions above certain thresholds not executed at normal market conditions would be covered, estimation of frequency of occurrence is not possible	Costs of dealing with the consequences of the negative vote.
Capacity to innovate	none	none	n.a.	n.a.
International competitiveness	Increased protection of minority shareholders might attract institutional investors	Flexibility of use of related party transactions might be reduced	Possible positive and negative impacts difficult to estimate	Possible positive and negative impacts difficult to estimate

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Annex XII: Shareholder engagement and financial services legislation

A number of specific EU acts regulate institutional investors and asset managers. The financial crisis has prompted the revision of some of these and the adoption of new rules for certain actors, for example the so called "alternative investment funds", such as hedge funds.

Rules adopted before the financial crisis focused primarily on improving the resilience of EU financial markets, while those adopted after the crisis aimed at establishing a safer, sounder, more transparent, but also more responsible financial system. Although some of the new rules have improved the "*internal governance*" of these actors (i.e. how they should organise themselves internally), such as for example the newly adopted rules on the remuneration of certain asset managers, they did not focus on the "*external governance*" aspects, that is, how they should interact with each other to provide for adequate incentives for shareholder engagement and what is expected from them as shareowners of companies.

Existing rules regulating the institutional investor and asset management sectors are the following.

As regards the activity of asset owners, Solvency I³⁸⁹ and II rules³⁹⁰ are applicable to insurance companies, including life insurance, while Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (IORP)³⁹¹ regulates pension funds.

As regards asset managers, the UCITS Directive³⁹², currently under revision³⁹³ and Directive 2011/61/EU on Alternative Investment Fund Managers (AIFM Directive 2011/61/EU)³⁹⁴ contain rules applicable to management through certain funds, while MIFID (Directive 2004/39/EC)³⁹⁵, currently also under revision³⁹⁶, is applicable to management under discretionary mandates.

Only some provisions from the above Directives have relevance from the perspective of shareholder engagement.

For asset owners, there are limited rules on fiduciary duties of pension funds and no framework at all for the disclosure of asset management mandates by asset owners. For assets managed under discretionary mandates, rules regarding asset managers are limited to the disclosure of investment strategies and costs in general. The framework for UCITS managers is more developed. Although professional investors also invest into UCITS, these funds are widely used by European households. It has been argued, however, that the specificities of UCITS funds, notably their liquidity needs hinder their ability to become long-term investors and may not give an appropriate incentive for shareholder engagement. Furthermore, UCITS fund managers are not allowed to acquire any shares carrying voting rights which would enable them to exercise significant

³⁸⁹ Directive 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance.

³⁹⁰ Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance . OJ 2009, L1.

³⁹¹ Directive 2003/41/EC.

³⁹² Directive 2009/65/EC.

³⁹³ COM(2012) 350 final.

³⁹⁴ Directive 2011/61/EU.

³⁹⁵ Directive 2004/39/EC.

³⁹⁶ COM(2011) 656 final and COM(2011) 652 final.

influence over the management of the issuing company (Article 56). In addition, UCITS are also hindered by law to establish concentrated portfolios, as the UCITS Directive does not allow UCITS to invest more than 5% of their assets in securities of the same issuer (Article 52).

1. Fiduciary duty

The first category of these rules is about fiduciary duty. Several Directives deal with fiduciary duties and provide that asset managers and pension funds should act in the best interests of their clients or beneficiaries.

For pension funds, Article 18 of the IORP Directive provides that "Member States shall require institutions located in their territories to invest in accordance with the "prudent person" rule and in particular in accordance with the following rules:

(a) the assets shall be invested in the best interests of members and beneficiaries. In the case of a potential conflict of interest, the institution, or the entity which manages its portfolio, shall ensure that the investment is made in the sole interest of members and beneficiaries;

(b) the assets shall be invested in such a manner as to ensure the security, quality, liquidity and profitability of the portfolio as a whole.

Insurance companies are not subject to any fiduciary duty at EU level.

With regard to asset managers managing portfolios under discretionary mandates, Article 19 of MIFID provides that Member States shall require that, when providing investment services to clients, an investment firm act honestly, fairly and professionally in accordance with the best interests of its clients. The MIFID implementing rules (article 35 of Directive 2006/73) provide that the asset manager should gather information about the investment objectives of the client, however, information on the length of time for which the client wishes to hold the investment should apply only with regard to retail clients and not for professional clients, such as pension funds and insurers.

For asset managers managing UCITS funds, Article 14 of the UCITS Directive provides that the management company shall act honestly and fairly and with due skill, care and diligence in the best interest of the UCITS and integrity of the market. Furthermore, UCITS management companies should act in such a way as to prevent undue costs being charged to the UCITS and its unit-holders.³⁹⁷

Alternative fund managers are required to act in the best interest of the alternative investment funds or the investors of the AIFs they manage and take all reasonable steps to avoid conflicts of interests (Article 12 of the AIFM Directive).

In view of the fact that these definitions are not specific enough and leave it open whether it involves shareholder engagement when it is in the best interest of the client, many contributors to the Green paper on Long-term financing support the revision of these definitions.

2. Decision on voting policies

³⁹⁷ Article 22 of UCITS implementing Directive 2010/43.

Both the UCITS implementing Directive 2010/43 and the AIFM Directive regulate voting policies (respectively Articles 21 and 37).

Both the UCITS management company and the AIF manager are required to set up a strategy for the exercise of voting rights attached to the financial instruments held by the UCITS/AIF they manage, with a view to ensuring that such rights are exercised to the exclusive benefit of UCITS/AIF.

This strategy shall determine measures and procedures for:

- a) monitoring relevant corporate events;
- b) ensuring that the exercise of voting rights is in accordance with the investment objectives and policy of the relevant UCITS;
- c) preventing or managing any conflicts of interest arising from the exercise of voting rights.

However, there is no obligation to be transparent about this policy, nor an obligation to provide it to unit holders.

3. Disclosure between asset managers and asset owners with regard to investment strategies and transaction costs

Asset managers regulated by MIFID are required to inform clients about investment strategies and costs³⁹⁸, but are not required to disclose transaction costs and associated charges to professional clients, such as insurers and pension funds. The MIFID Implementing Directive requires that a notice of the possibility for the emergence of transaction costs that are not paid by the investment firm or imposed by it should be provided only to retail clients only.³⁹⁹

Alternative investment fund managers are required to disclose to asset owners the description of the investment strategy and all charges⁴⁰⁰, but there are no specific rules on whether these include portfolio turnover costs or not.

UCITS fund managers are required, on request of the UCITS investor, to provide data regularly on the changes in the composition of the portfolio and the portfolio turnover costs.⁴⁰¹

Annex XIII: Overview of the replies to the consultation on long-term financing relevant for the present impact assessment

³⁹⁸ Article 19 of MIFID.

³⁹⁹ Article 33 of Commission Directive 2006/73/EC.

⁴⁰⁰ Article 23 of the AIFM Directive.

⁴⁰¹ Article 75 of Directive 2009/65.

The public consultation on the Green Paper yielded nearly 300 responses from a wide range of stakeholders. The large majority of responses come from the financial sector and a considerable part of them from think tanks and other similar NGOs. Most of the replies come from respondents located in the UK, France and Germany respectively or represent cross-border EU organisations. Only 11 Member States replied.

Respondents overwhelmingly welcomed the initiative as a positive and useful framework for debate on this topic and what more may need to be done to bring significantly more long-term financing to the economy. Many respondents comment on the importance for long-term investment in having a supportive macroeconomic context. There seems to be wide agreement that investors have a key role to play in promoting a longer-term, investment-oriented outlook among companies.

The respondents also agree on the opportunities of long-term investments for institutional investors. Institutional investors argue that they can help support economic growth as they are natural long-term investors. For example Insurance Europe states that insurers' investment in long-term assets is a natural consequence of their liabilities, that is investing in assets is not an aim *per se*, but a consequence of insurers' primary role of providing protection and managing policyholders' savings. Pensions Europe argues that the match with the long duration and maturities of their liabilities, often amounting to as much as 10-25 years, makes pension funds very suitable long-term investors.

Respondents argue that the ability of these investors to invest on the long-term depends on a range of factors, including the regulatory framework, investment skills, taxation regimes and investment mandates. As regards the regulatory framework, insurance companies, as an example, argue that existing prudential regulation have influenced investment behaviour and constrained the long-term outlook of their investments. The Solvency II regime is frequently cited in this context.

The consultation had a specific chapter on the possible incentives that could help promoting better long-term shareholder engagement. It has to be emphasised that the questions raised in this Green paper have been formulated in an open way in order for the widest possible range of ideas to be channelled through. Therefore it is not possible to give an exact breakdown of respondents supporting or not a certain policy action.

The questions under the corporate governance chapter have been the following.

Q. 21. What kind of incentives could help promote better long-term shareholder engagement?

Q. 22. How can the mandates and incentives given to asset managers be developed to support long-term investment strategies and relationships?

Q. 23. Is there a need to revisit the definition of fiduciary duty in the context of long-term financing?

The below analysis focuses on those issues which are relevant for the present impact assessment.

Q. 21. What kind of incentives could help promote better long-term shareholder engagement?

The following ideas have been put forward by at least a few respondents and appear to be widely supported as regards **possible ways of incentivising better long-term shareholder engagement**:

1) a common EU framework for disclosure on how environmental, social and governance (ESG) issues are taken into account in the investment strategies of asset owners and asset managers or encouraging asset owners to include ESG matters into mandates.

This issue has been raised by PensionsEurope, the umbrella organisation of European pension fund associations and other stakeholders, such as pension funds, asset managers, insurers, banks and the association of responsible investors in Europe (Eurosif, representing 60 investors and 8 national responsible investment fora).

2) encouraging better alignment of incentives throughout the equity investment chain, reducing the emphasis on short-term performance metrics reporting and benchmarking.

This issue has been raised by many stakeholder organisations, such as for example EuropeanIssuers and the European Roundtable of Industrialists from the issuer side, the European Federation of Financial Services Users, representing the final beneficiaries of the investment chain, and investor associations, such as for example Eurosif, the French Federation of Insurance Companies and the Dutch corporate governance forum of investors, Eumedion. Many other individual respondents support this policy objective (see under specific policy actions).

3) developing an EU Stewardship Code for investors or promoting the adoption of stewardship Codes or enforcing them more effectively.

Many organisations, such as European Issuers, the Quoted Companies Alliance and the European Banking Federation and investors would be in favour of promoting the adoption of Stewardship Codes, and some have promoted the development of an EU Stewardship Code. EFAMA, the umbrella organisation of European Asset Management associations would be in favour of enforcing such Codes more effectively.

4) shareholder say on pay as a means of communication with investee companies' management.

This issue has been raised by PensionsEurope.

Q. 22. How can the mandates and incentives given to asset managers be developed to support long-term investment strategies and relationships?

Many respondents agreed that mandates provide important mechanisms for changing the time horizon applied by investors and that these mandates should be structured to encourage a strong focus on the long-term. Some respondents specifically mentioned that the asset management mandates should encourage asset managers to adopt investment strategies based on the understanding of the underlying value of the business and how that could contribute to the long-term investment objectives of the client. A large number of respondents argued for more

transparency in general between the different players of the equity investment chain (European Banking Federation, Confederation of British Industry, ETUC, Eumedion, UK Sustainable Investment and Finance Association) or promoting better interaction between these.

Many have specifically referred to the following policy actions:

1) pension funds voting and engagement policies should be integrated into the investment process / more transparency about engagement and voting policies and activities of asset owners and asset managers to the public

Many respondents representing a wide range of the relevant stakeholders, including several pension funds, their organisations (UK National Association of Pension Funds, Association of British Insurers) and asset managers (European Fund and Asset Management Association), banks (European Banking Federation) the regulatory side (Austria, Finland), issuers (French Association of Private Companies, European Confederation of Directors' Associations) and others (the UK ShareAction for responsible pensions) have promoted action in this area.

2) transparency about the portfolio turnover and costs or restrictions on turnover

Many respondents representing all the relevant stakeholders, including issuers (EuropeanIssuers, the French association of private companies (AFEP), the regulatory side (UK Financial Regulatory Council), several pension funds and asset managers have raised this issue.

3) transparency about how asset owners have taken into account the best interest of their beneficiaries when issuing mandates and how asset managers have fulfilled their long-term fiduciary duties or improve the compliance of institutional investors with their fiduciary duties and formalize rules for its exercise

Many respondents representing all the relevant stakeholders, including issuers (Quoted Companies Alliance, Association of European Chambers of Commerce and Industry), the regulatory side (UK Financial Reporting Council, Ireland), several pension funds and asset managers and the European Federation of Financial Services Users have raised this issue.

3) fund manager performance to be reviewed over longer time horizons than the quarterly cycle / using other metrics than market index benchmarks, for example absolute performance metrics

It is this issue that gathered the largest number of comments and strongest support. Respondents representing all the relevant stakeholders, including issuers (EuropeanIssuers), the regulatory side (UK Government, Ireland), several pension funds and asset managers and their organisations (European Fund and Asset Management Association, European Financial Services Roundtable, French Federation of Insurance Companies, the UK ShareAction for responsible pensions) think tanks (CFA Institute) and others have raised this issue.

4) transparency of the pay structures of asset managers or EU rules to require long-term performance payments for asset managers

Many respondents representing all the relevant stakeholders have raised this issue. There appears to be considerable support for EU rules to require long-term performance payments for asset

managers (for example PensionsEurope and the European Federation of Financial Services Users, but also and many other respondents would be in favour) and important stakeholders would be in favour of more transparency (for example the European Banking Federation).

5) promotion of existing standard management mandate templates

Several asset owners and responsible investment associations (for example, the UK Sustainable Investment and Finance Association and UNEP FI, the UN Sustainable Finance Initiative) have promoted this idea.