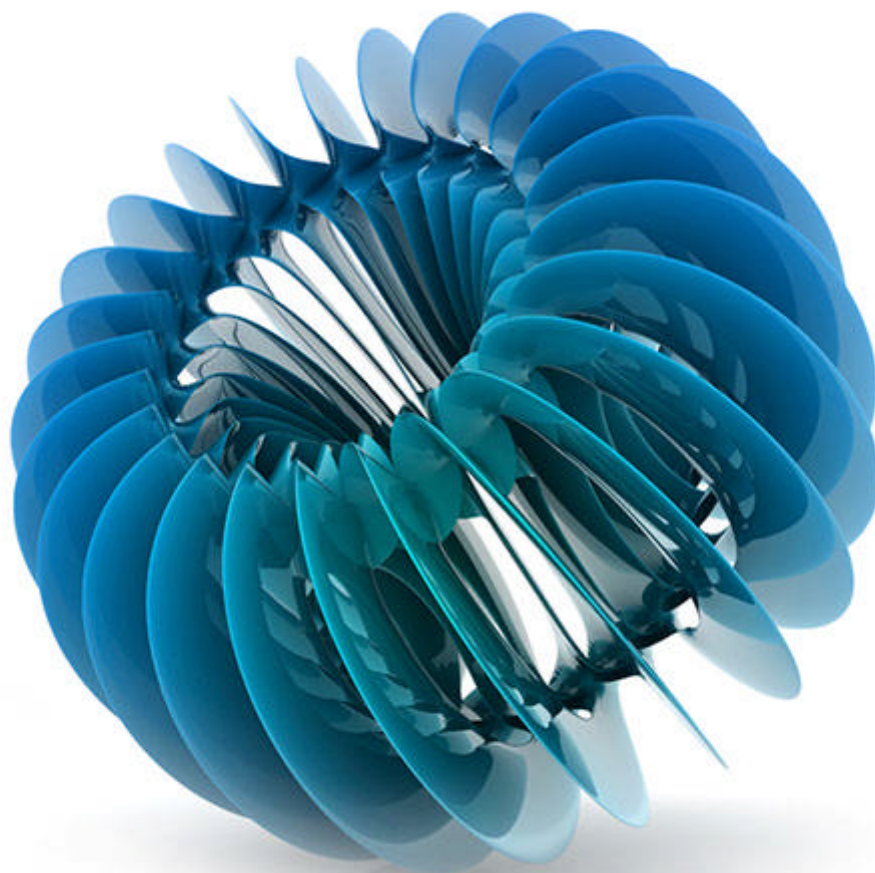


ALLEN & OVERY



September 2012

Corporate Governance Comparative Study

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Introduction

The purpose of this study is to establish whether there is a need for the Belgian Corporate Governance Committee (the **CGC**) to make revisions to the Belgian 2009 Corporate Governance Code (the **Belgian 2009 Code**). This need is being assessed by comparing the Belgian 2009 Code to the codes of neighbouring countries. The study focuses on: (i) the dynamics of the codes and the revision and monitoring procedures in the aforementioned countries, and (ii) certain themes proposed by the CGC.

Revisions of existing corporate governance codes are generally boosted by various drivers, including EU influences, the shift from soft law to hard law, (perceived) best practices and market expectations, and lessons learned from compliance monitoring. The financial crisis, which has recently uncovered and highlighted several problem areas, currently is also functioning as a catalyst for revisions of corporate governance codes.

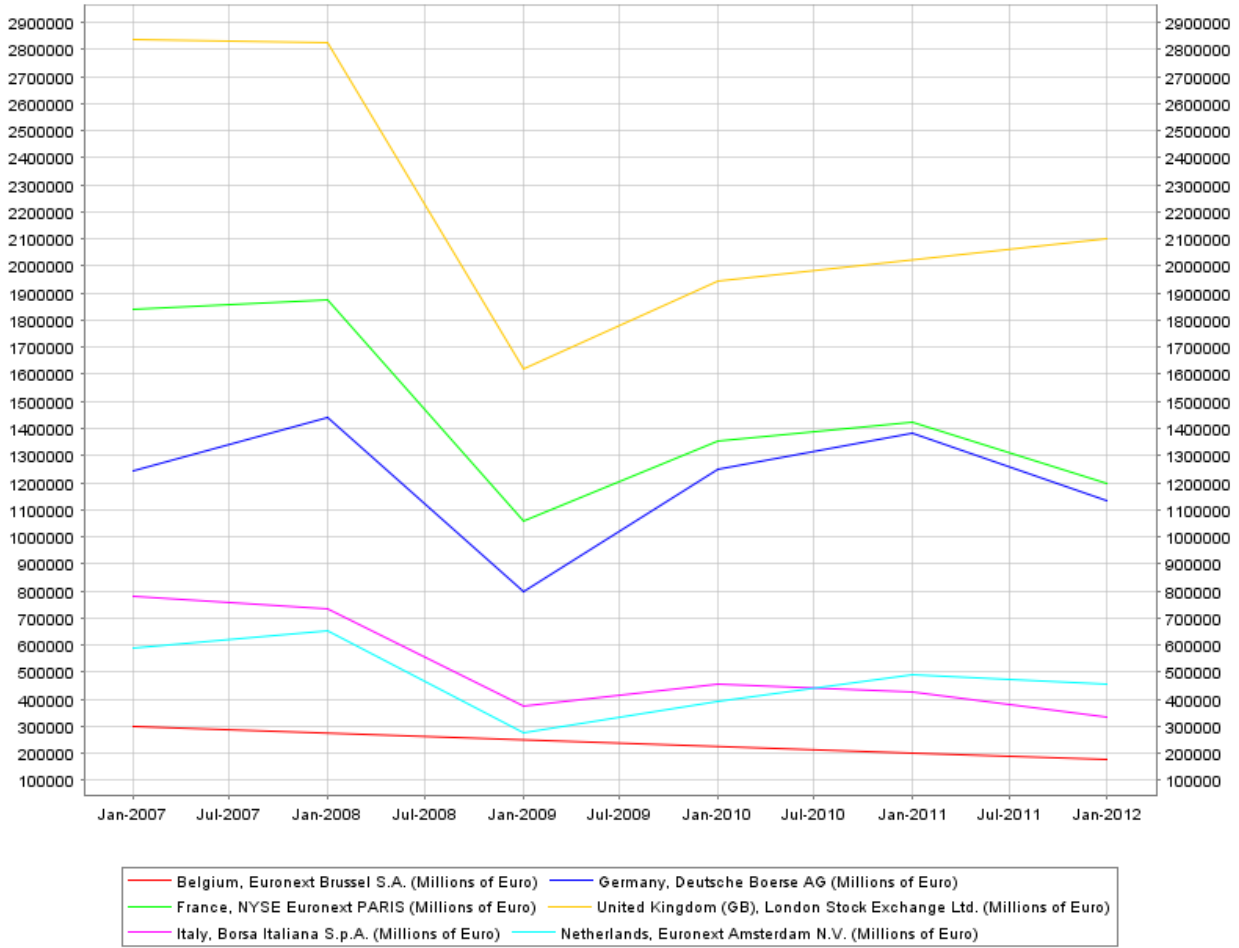
When revising or updating corporate governance codes, drafters need to consider the codes' particular corporate environment: the specific legal context, an existing balance of powers and national specificities (for example, as is the case in Belgium, a predominant controlled ownership structure or a significant presence of small listed companies). Also, several concerns generally need to be taken into account, such as the desire to: (i) preserve the flexibility of the corporate governance rules; (ii) avoid placing too cumbersome a burden on companies; and (iii) avoid a formalistic box-ticking application of rules or evaluation of the compliance with these rules.

Thus, the drafters of the codes must find a happy medium between, on the one hand, responding to all driving forces and living up to best practices whilst, on the other hand, taking into account the specific corporate environment and other variables and concerns. Ultimately, the codes must 'have teeth' and must create an attractive investment environment.

The CGC aims to have an advanced and well developed Belgian corporate governance code. This is important in order to maintain the confidence of the market (including foreign investors) in Belgian listed companies. Starting from this perspective, we assess in this study whether the Belgian 2009 Code, in the current circumstances and bearing its own context in mind, needs to be updated.

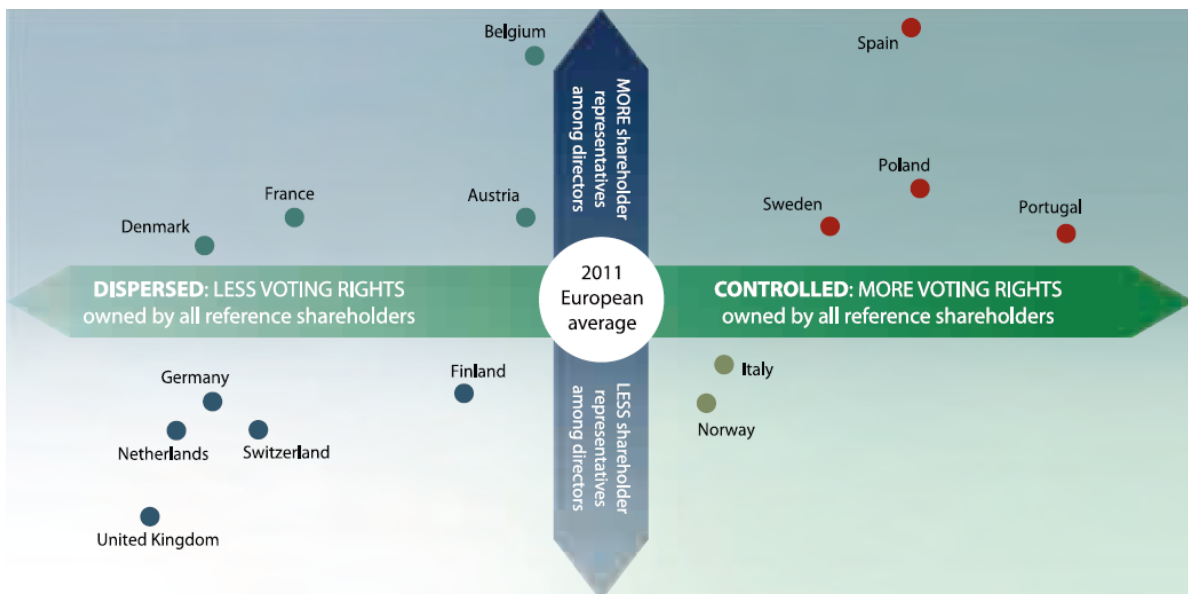
This assessment is carried out by, among others, comparing the Belgian 2009 Code to the codes of France, Germany, the Netherlands and the United Kingdom, and for certain matters, Italy. The choice of the five countries allows a meaningful comparison to be made between neighbouring jurisdictions, which have similar or overlapping legal traditions, but which at the same time present remarkable and interesting differences.

However, the findings resulting from the comparison should be read taking into account the different specificities in the various jurisdictions. The tables below illustrate (i) the market capitalisation position of Belgian listed companies vis-à-vis the market capitalisation position of listed companies in the other studied jurisdictions; as well as (ii) how Belgian listed companies are positioned compared to other European jurisdictions regarding reference shareholder power.



* Securities exchange - Trading Statistics, Annual, Market capitalisation of listed companies (domestic equities and exclusive foreign listings), Equity excluding investment fund shares, Euro - Source: <http://sdw.ecb.europa.eu/browseChart.do?>

The table above illustrates the market capitalization of the companies listed in the studied jurisdiction. The average Belgian listed company has indeed a low market capitalisation compared to that of the listed companies in the other five countries studied.



Source: Heidrick & Struggles, European Corporate Governance Report 2011: Challenging board performance, available on http://www.heidrick.com/PublicationsReports/PublicationsReports/HS_EuropeanCorpGovRpt2011.pdf (based on BEL20 companies only)

The table above illustrates the reference shareholder power in several European jurisdictions (including voting rights owned by reference shareholders and their representatives on the board). Please note that only the (then) BEL20 companies are regarded in this table; when taking into account all Belgian listed companies, Belgium is likely to be positioned among the jurisdictions with a predominantly controlled ownership of companies (in the upper right corner).

Considering the differences in size of the listed companies in the studied jurisdictions, the disparities in predominant ownership structures (ie dispersed and controlled shareholdings) and board structures (ie unitary structures and two-tier systems) and the specific legal context, the results of the comparison made in this study, must be read and understood in the light of the different specificities in these jurisdictions.

1. Executive Summary

- The Belgian 2009 Code is the second oldest code of the six studied jurisdictions. The purpose of this study is to analyse whether a revision of the Belgian 2009 Code is required.
- With only one amendment (which is below average in the EU), the Belgian corporate governance code has remained relatively stable since its inception. Nevertheless, the Belgian 2009 Code still compares favourably with the studied jurisdictions. Moreover, a few substantive revisions may be more ‘palatable’ than frequent minor updates.
- The Belgian 2009 Code has been legally embedded as reference code by way of a royal decree, to which the 2009 Code is attached. Unlike in France and the United Kingdom, but similar to the situation in the Netherlands, the legal embedment of specifically the Belgian 2009 Code, means that future amendments of the code not only require a decision of the CGC, but also recognition as a reference code by royal decree. This complicates the amendment procedure and deprives the code to some extent of one of the main features of soft law, namely its flexibility. However, pending a revision, the legal embedment of the Belgian 2009 Code does not prohibit the CGC from issuing further guidance in addition to the Belgian 2009 Code (which goes beyond the Belgian 2009 Code but is not subject to the 'comply or explain' mechanism).
- Generally speaking, there are four reasons for amending or updating existing corporate governance codes:
 - to implement or adapt to European directives, regulations or recommendations;
 - to avoid inappropriate discrepancies between the code and the law (eg following a shift from soft law to hard law);
 - to stay in line with the best practices, and remain progressive; and
 - based on practical experience: to clarify, complete, add detail, add guidance, and remedy interpretation issues.
- Overall, Belgian law and the Belgian 2009 Code are characterised by an above average implementation of EU requirements on corporate governance. The few departures from the recommendations of the European Commission are not material.

Many changes in the field of corporate governance are expected at EU level. It is likely that a substantial number of these changes will be included in directives or regulations, and will therefore require implementation into national law ('hard law'). Amending the Belgian 2009 Code to address certain issues now, ahead of the proposed changes at EU level, is unlikely to prevent new hard law and may even complicate issues further by requiring further amendments to the code in order to bring it into line with the new legal provisions. In our view, there currently is no need stemming from the EU level, that urgently requires an amendment to the Belgian 2009 Code. Belgium may want to wait for EU initiatives in this area.

- With the enactment of corporate governance rules in law, overlaps arise between legal provisions and provisions of the corporate governance code. These overlaps are acceptable and may even be desirable as long as (i) there are no inconsistencies between legal provisions and code’s provisions; and (ii) the corporate governance code is still readable and comprehensible.

The Belgian 2009 Code includes recommendations that are sometimes more stringent and sometimes weaker than the law. In the latter case, the relevance of the provision is questioned (and more generally, the authority of the code is fettered). Technically, though, in view of the overlap between soft law and hard law, we see no urgent need to

amend the Belgian 2009 Code, but would recommend rectifying some inconsistencies in a subsequent change.

- The main trends which can be distilled from the recent or envisaged changes in Belgium’s neighbouring countries concern boardroom diversity, independent directors, directors’ remuneration, the remit of the audit committee, the role of the external auditor and shareholder engagement.

Whereas, formerly, there were often frequent revisions, nowadays there are discernable trends towards keeping changes to a minimum, with increased attention being paid to (i) adherence to the spirit of the code (with an emphasis on qualitative ‘explaining’ and behavioural rules) rather than to the letter of the code (ie a box-ticking application of code), and (ii) the specific needs of different types of companies.

- There is a trend towards placing corporate governance in a broader context. Recommendations are not only addressed to boards (the main ‘audience’ of the corporate governance codes), but also to shareholders, individual directors, management and auditors. Other tools for the other focus groups may be more adequate.
- The increased focus on shareholder engagement, stewardship and shareholder transparency is an important trend, which seems irreversible. On this theme, there are rapid developments and the Belgian governance framework, which is quite limited (as in most other continental countries), may require updating in the short term.

At EU level, there are currently some proposals on the table which aim to enhance shareholder engagement, focussing mainly on institutional investors. These proposals are only at an early stage of development and it is unclear how they will evolve. They may not be fully adequate for jurisdictions with a predominant controlled shareholding.

However, the corporate governance codes may not be the most appropriate tool to address shareholders. The shareholder governance rules should preferably be laid down in a separate code or a guidance note, which is not legally embedded.

- The question whether corporate governance rules should be tailored to small- and medium-sized listed companies is relevant for this study, since these companies are numerous in Belgium. The topic is much debated. Pros and cons seem evenly matched.

More attention for high-quality ‘explaining’ (possibly in combination with indications of provisions which are less relevant for small- and medium-sized listed companies) could increase the market acceptance of the ‘explaining’. It could take away the negative connotation of non-compliance and could allow for applying the existing ‘uniform’ codes to small- and medium-sized listed companies.

On the other hand, we are not opposed to establishing a separate code for small- and medium-size companies provided that it is optional and substantially in line with other precedents or even part of a joint cross-border initiative (eg by NYSE Euronext).

- Confronted with a formalistic application of the codes, the authors of the codes may be inclined to go beyond the compliance-driven and procedural provisions and promote a more performance and behavioural approach.

The Belgian 2009 Code contains a rather extensive set of both ethical and qualitative rules of conduct for directors. However, a corporate governance code may not be the most suitable place for rules governing directors’ conduct, since a corporate governance code is by definition addressed to the companies (and thus to the boards of directors as a whole and not the individual directors).

We welcome the upcoming Guberna initiative of providing guidance specifically addressed to individual directors (“*Toolkit for the Director*”). The code can then recommend that these individual rules of conduct are assessed (i) as

part of the directors' evaluation and (ii) in the context of the directors selection process.

- The current emphasis in statutory audit regulation is to address issues in hard law. We perceive an important trend towards EU harmonisation, with proposals for direct effect regulation.

Corporate governance codes may still have some relevance in statutory audit regulation, for instance in (i) developing and providing guidelines on legal provisions and (ii) providing additional recommendations. However, in our view, Belgium does not yet need to alter the existing code provisions concerning statutory audit for the following two reasons:

- in view of the expected EU amendments, the authors of the codes may want to await for the EU initiatives to take effect; and
 - with respect to the current situation in Belgium, although a few changes could be proposed which are not covered by the current EU proposals, these changes do not, in our view, require urgent action.
- The chairman of a board, as 'primus inter pares', may have a considerable impact on the functioning of the board and on communication with the shareholders. The role may range from procedural tasks (eg setting the board's agenda, leading the evaluation of the board) to more general duties (eg building trust, stimulating team dynamics and encouraging a culture of openness and debate).

In the Belgian 2009 Code, the role of the chairman has been set out quite extensively and Belgium is clearly a frontrunner on this issue. Belgium could draw inspiration from the UK where the chairman's role is even more developed, but again, the national environment needs to be taken into account. In our view, changes to the Belgian 2009 Code regarding the role, powers and capacities of the chairman are not pressing.

- When updating the code, we would encourage the CGC to conduct or commission a broad monitoring study on compliance with the Belgian 2009 Code. Limited monitoring exercises, such as only monitoring large companies (eg only BEL 20) may give a misleading view of compliance levels and an incomplete view of reasons for non-compliance. The results of a comprehensive market-wide monitoring study would allow the CGC to identify the need for clarification, guidance or the need for the revision of certain recommendations.
- Overall, it appears to us that amending the Belgian 2009 Code is not yet absolutely necessary.

2. Dynamics of corporate governance rules

2.1 Drafting of the codes

(a) Corporate governance codes: genesis and updates

In the last decade, the studied jurisdictions have made great progress in the field of corporate governance. The initiative for drafting and updating the corporate governance codes was taken up by different organisations. All of the codes have been updated at least once, and some several times.

The United Kingdom

In May 1991, the Corporate Governance Committee was set up by the Financial Reporting Council (the **FRC**), the London Stock Exchange and the accountancy profession in response to concerns in the business community about the standards of financial reporting and accountability. Its task was to review the aspects of corporate governance which relate to financial reporting and accountability. In 1992, a series of recommendations were set out in the Cadbury Report, which published the first version of the UK Corporate Governance Code (the **UK CG Code**). Since 1992, the recommendations set out in the Cadbury Report have been added to at regular intervals. In 1995, a separate report set out recommendations on the remuneration of directors. In 1998, the two reports were brought together in a single code. This code was initially known as the Combined Code on Corporate Governance, but it is now known as the UK CG Code.

The FRC has updated the UK CG Code at regular intervals. The UK CG Code was substantially revised in 2010, and recently in 2012 a new edition of the UK CG Code was published, following public consultations in 2011 and 2012, to reflect changes relating to audit committees and boardroom diversity. In July 2010, following a request from the then government, the FRC published the Stewardship Code. The origins of the Stewardship Code can be traced back to the “*Responsibilities of Institutional Shareholders and Agents: Statement of Principles*”, which was first published in 2005 by the Institutional Shareholders Committee (ISC) and then converted into a code in 2009. The Stewardship Code aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities. The FRC has recently published, following public consultation, a new edition of the Stewardship Code.

In addition to the UK CG Code and the Stewardship Code, the FRC has published a series of guidance notes, which are aimed at assisting companies by addressing specific aspects of governance and accountability.

France

In France, there are two corporate governance codes to which the French listed companies may refer, the AFEP MEDEF Code and the Middennext Code (collectively referred to as the **French CG Codes**). Both codes originate from initiatives from the business community.

(i) The AFEP MEDEF Code

In 2003, the AFEP (*Association Française des Entreprises Privées*) and the MEDEF (*Mouvement des Entreprises de France*) issued the first version of their code (the **AFEP MEDEF Code**). It summed up the conclusions of various reports ordered by the AFEP and the MEDEF and drafted by working groups composed of top managers and lawyers of French listed companies during the period 1995 to 2002 (ie the Viénot reports of July 1995 and July 1999, and the Bouton report of September 2007).

The AFEP is a private association that represents the interests of a small number of French listed companies (about 80 companies), which have very significant market capitalisations. All the companies composing the CAC 40 Index are members of the AFEP. The MEDEF is the largest private association in France, representing the interests of a wide group of entrepreneurs (750,000 French companies).

Since 2003, the AFEP MEDEF Code has only been amended three times:

- in January 2007 and October 2008, in order to include recommendations relating to the compensation of executive directors of listed companies; and
- in April 2010, in order to include recommendations relating to increasing the presence of women on the boards.

(ii) The Middennext Code

In 2009, Middennext, an independent, French, professional association representing listed small- and medium-sized companies, decided to draw up its own corporate governance code (*'Code de Gouvernement d'entreprise pour les Valeurs Moyennes et Petites'*) (the **Middennext Code**). The Middennext Code is based on the report issued by the independent expert, Professor Pierre-Yves Gomez, and his team.

The decision by Middennext to draft a specific set of principles, constituting an alternative to the AFEP MEDEF Code, was made in response to feedback received from managers of small- and medium-sized companies which believed that some of AFEP MEDEF recommendations were not suited to their situation.

This Middennext Code is now recognised as a reference in the context of the 'comply or explain' principle. Companies may opt to comply with this code, instead of with the AFEP MEDEF Code, provided that the Middennext Code then constitutes their sole standard. Indeed, the AMF has specified that a double reference or a mixed reference is not considered acceptable.

The Middennext Code has not been amended or updated since its implementation.



Germany

In 2002, a Government Commission (the **German CG Commission**) appointed by the Federal Minister of Justice adopted the German Corporate Governance Code (the **German CG Code**). At present, the German CG Commission consists of 14 individuals, who are prominent academics, attorneys and representatives from companies, trade unions and associations, appointed by the Federal Minister of Justice. It oversees the development of corporate governance in legislation and practice, and reviews the German CG Code regularly, usually once a year, to consider the need for possible amendments.

The German CG Code was last updated in May 2012.



The Netherlands

In June 1997, the first Dutch Corporate Governance Committee (the **Peters Committee**) published a report: *'Corporate Governance in the Netherlands; the Forty Recommendations'* (the **Forty Recommendations**). The Peters Committee was formed as part of an agreement between the Association of Securities-Issuing Companies and the Amsterdam Stock Exchange Association (the predecessor of Euronext Amsterdam) regarding anti-takeover measures.

In response to the lack of compliance with the Forty Recommendations, a much more widely supported committee, called the Tabaksblat Committee, was established in 2003. The Tabaksblat Committee was installed by Euronext Amsterdam, the Netherlands Centre of Executive and Supervisory Directors, the Foundation for Corporate Governance Research for Pension Funds, the Association of Stockholders, the Association of Securities-Issuing Companies, and the Confederation of Netherlands Industry and Employers, together with the Minister of Finance and the Minister for Economic Affairs. In December 2003, the Tabaksblat Committee issued the Dutch Corporate Governance Code (the **Dutch CG Code**).

In December 2004, the Minister of Finance, acting in its own capacity and also on behalf of the Minister of Justice and the State Secretary for Economic Affairs, established the first Monitoring Committee of the Corporate Governance Code (the **Monitoring Committee**). The first Monitoring Committee is also known as the Frijns Committee.

The last revision to the Dutch CG Code was made in December 2008 by the Monitoring Committee at the request of the National Federation of Christian Trade Unions in the Netherlands, Eumedion, the Federation of Dutch Trade Unions, the Netherlands Centre of Executive and

Supervisory Directors, NYSE Euronext, the Association of Stockholders, the Association of Securities-Issuing Companies, and the Confederation of Netherlands Industry and Employers. The Dutch government endorsed this request.

In July 2009, the Minister of Finance, the Minister of Justice and the Minister of Economic Affairs established the second Monitoring Committee, which is known as the Streppel Committee. The members of this Monitoring Committee have been appointed for a four-year term.

In Belgium, the first corporate governance code (the **Lippens Code**) was published in 2004 by the CGC. The Lippens Code was created by the CGC acting on the initiative of the Banking, Finance and Insurance Commission, the Federation of Enterprises in Belgium (**FEB**), and Euronext Brussels. The Lippens Code was published later than the codes in Belgium's neighbouring countries. As a result, it was quite progressive, since the committee could draw inspiration from well developed examples, such as the UK CG Code.

In March 2009, the CGC published the second and current edition of the code, ie the Belgian 2009 Code. The Belgian 2009 Code is the second oldest code of the six studied jurisdictions.¹

(b) Structure of the codes

The structure of corporate governance codes varies greatly throughout the EU member states. However, this variance is not necessarily reflective of the quality of the codes. Instead, it is a result of the differences in the objectives of the corporate governance rules, in legal traditions and in legal frameworks in those member states.

We find that the codes of the studied jurisdictions (Belgium, France, Germany, the Netherlands, and the United Kingdom) differ mainly: (i) in their format (ie whether the provisions are set out as one category or whether they are broken into several categories, such as principles, provisions and guidelines); and (ii) in their scope, descriptiveness and level of detail. If provisions are set out in different categories, the set up of the different provisions is often related to whether or not the 'comply or explain' principle should apply to the relevant provision.

These differences (format and scope/detail) do not necessarily interrelate. As indicated in the study on monitoring commissioned by the EC² (the **Monitoring Study**), the format of the codes (ie the organisation of the provisions) does not necessarily affect their level of detail.

Finally, the setup of the corporate governance rules is, in certain member states, influenced by the size of the companies for which the rules are designed. The most striking example is France, which created the Middenext Code to address the needs of small- and medium-sized listed businesses after managers complained that the AFEP MEDEF Code was more suited to larger companies. The topic of corporate governance rules reflecting company size is addressed in section 3.3(c) of this study.

In part as an illustration of the above, the summary by jurisdiction below concisely presents the main structural characteristics of the codes of the United Kingdom, France, Germany, and the Netherlands and how they apply the 'comply or explain' principle.

The United Kingdom

The UK CG Code is not a rigid set of rules. It consists of 18 **main principles** of good governance, most of which have their own set of **supporting principles** which add more detail to the main principles, and more detailed **code provisions**, which set out specific recommendations as to how the main principles may be implemented. The UK CG Code is applied on a 'comply or explain' basis.

¹ The Dutch CG Code dates back to 2008. The Dutch Corporate Governance Committee does currently not plan to amend the Dutch CG Code (see below).

² 'RiskMetrics Group, BUSINESSEUROPE, ecoDa and Landwell & Associés, *Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States*, September 2009, p. 25

Companies are required by the Listing Rules to apply the main principles (and the supporting principles) and must state in their annual report how they have applied them. They must also state whether they have complied with all the relevant code provisions during the period under review. If they have not complied with a particular code provision during the year, they must explain why, state the period of non-compliance, and explain how they have applied the relevant main principle.

Some of the provisions of the UK CG Code only apply to the FTSE 350: the 350 largest companies in the FTSE share index.

The Stewardship Code consists of seven **principles** and **guidance** on each principle. The ‘comply or explain’ principle also applies to the Stewardship Code.



France

The AFEP MEDEF Code consists of a single set of **recommendations**. The ‘comply or explain’ principle applies to all of these recommendations.

The Middelnext Code contains: (i) *‘points de vigilance’* (attention points) which are presented in the form of questions which the board of directors must consider; and (ii) **recommendations** which the companies must adhere to and to which the ‘comply or explain’ principle applies. In its last review of the reports issued by the board chairmen of French listed companies, the AMF recommended that companies which refer to the Middelnext Code, should mention in their reports that the board has taken note of these attention points. If the board did not take note of the attention points, the AMF recommended that the reasons why should be indicated in their reports. The AMF is considering whether to request that the boards of those companies that refer to the Middelnext Code, issue an assessment of these attention points.



Germany

The German CG Code consists of **recommendations** (which are marked by the use of the word ‘shall’) and **suggestions** (which are marked by the use of the word ‘should’). The ‘comply or explain’ principle only applies to recommendations. The executive and the supervisory board of each listed company have to declare each year whether they have followed the recommendations during the previous year and whether they intend to follow them the following year. Recommendations which have not been complied with (or which will not be complied with) have to be listed and for each so listed recommendation an explanation has to be given as to why the recommendation has not been followed.

To ensure a clear understanding of the recommendations and suggestions, the German CG Code sometimes repeats compelling provisions of the law (or the general idea of those provisions). They are shown in the text as indicative statements (ie without being marked ‘shall’ or ‘should’).



The Netherlands

The Dutch CG Code consists of (i) **principles** and (ii) **best practice provisions** which elaborate on the principles. Listed companies must state in their annual report whether they applied the principles and provisions in the past year, and must explain, as the case may be, why a principle or a provision was not applied. The ‘comply or explain’ principle applies to both principles and provisions. The annual report only has to address compliance with principles and provisions that are directed at the board of directors or the supervisory board of the company. For example, there is no need for the companies to report on compliance with provisions relating to shareholders, institutional investors or the auditor. Indeed, the Dutch CG Code addresses several categories of stakeholders, some of which also need to apply the ‘comply or explain’ principle (eg the institutional investors, see further in section 3.3 (b)).

The Belgian 2009 Code consists of three types of provisions, namely principles, provisions and guidelines. The nine **principles** (*principes*) are the pillars of good corporate governance and must always be complied with. The **provisions** (*bepalingen/dispositions*) describe how these nine principles must be applied. The ‘comply or explain’ principle is applicable to these provisions. The provisions are supplemented with **guidelines** (*richtlijnen/lignes de conduite*), to which the ‘comply or explain’ rule does not apply.

In addition, the Belgian CGC has issued certain additional recommendations, referred to as **practical rules** (*vuistregels/règles pratiques*) (eg for the procedure regarding nomination and re-election of the external auditor and for providing high-quality explanations) or **guidance documents** (*hulpdocument/document d'aide*) (eg regarding the description of the main features of the company's internal control and risk management systems).

These practical rules and guidance documents are technically not part of the Belgian 2009 Code, which is legally embedded (see section (c)). Also, the 'comply or explain' principle does not apply to these recommendations. From a user's perspective, these recommendations have a status that is similar to the guidelines in the Belgian 2009 Code.

Given the differences in structure, approach and writing style, it is difficult to make an overall comparison of the scope of the codes in all the jurisdictions reviewed. However, in section 3, such a comparison will be presented for certain themes which are discussed in more detail below.

Although the structure of the various codes and the corresponding scope of application of the 'comply or explain' principle, varies between the different jurisdictions, there seems to be a consensus in the EU that the 'comply or explain' principle is an effective principle in corporate governance codes, as it allows for flexibility when complying with corporate governance codes.

(c) Legal embedment of corporate governance rules

The EU Directive 2006/46/EC introduced, among other things, a provision requiring listed companies to produce a corporate governance statement in their annual reports. The statement must refer to the corporate governance code applied by the company, and explain whether, and to what extent, the company complies with that code.

"A company whose securities are admitted to trading on a regulated market [...] shall include a corporate governance statement in its annual report."

Directive 2006/46/EC

Consequently, most EU member states implementing the Directive have imposed a legal obligation for listed companies to refer to the corporate governance code and to apply the 'comply or explain' principle. In different jurisdictions we find different approaches to the legal embedment of, and more specifically to the manner of referring to, one or more of the codes (ie whether they are specifically referred to).

UK

The 'comply or explain' principle in the UK CG Code is underpinned by an appropriate regulatory framework predominantly set out in CA 2006. Section 1269 CA 2006 implemented changes to the Financial Services and Markets Act 2000 to give power to the Financial Services Authority (FSA) (in section 890) to make corporate governance rules. The FSA introduced corporate governance rules in the Disclosure and Transparency Rules (DTR 7). Responsibility for the UK CG Code was given to and remains with the FRC. The legal provision is in section 1273 CA 2006 and provides that regulations may 'make provision by reference to any specified code on corporate governance that may be issued from time to time by a specified body'. This is reference to the UK CG Code issued by the FRC.

The regulatory framework is reinforced by the detailed rules imposed by the FSA that must be followed by companies listed on the London Stock Exchange. For companies with a premium listing this includes the requirement to provide a 'comply or explain' statement in the annual report, explaining how the company has applied the UK CG Code (LR 9.8.6).

France

Since 2008, articles L225-37 and L225-68 of the French commercial code include certain corporate governance rules and refer to 'a corporate governance code developed by business organisations'.

In its second paragraph the articles indeed state: “*When a company voluntarily refers to a code of corporate governance developed by business organisations, the report of the chairman of the board also specifies the provisions that have been deviated from and the reasons therefore. It is furthermore clarified where this code is available. If a company does not refer to such a code of corporate governance, the report must also state which rules were applied, in addition to the legal requirements, and explain why the company decided not to apply any provision of this corporate governance code.*”.

The ‘comply or explain’ principle is consequently legally embedded. The reference in the law to ‘*a corporate governance code developed by business organisations*’ (rather than to a specific code of a specific date) allows for flexibility in amending the code without the intervention of the legislator or government.

If a French listed company refers to a code, it must opt for a specific one (ie it cannot mix the recommendations of the two codes, or choose one recommendation from one code and another from the other code, depending on the addressed principles).

Germany

Since the beginning of 2002, the German CG Code has had a legal basis. Article 161 of the Stock Corporation Act, with the title ‘*Declaration regarding the Corporate Governance Code*’, states: “*The executive board and supervisory board of the exchange-listed company shall declare once a year that the recommendations of the Government Commission on the German Corporate Governance Code published by the Federal Ministry of Justice in the official section of the Federal Gazette, have been and are being complied with, or shall declare which of the Code’s recommendations are not being applied and if so why not. The declaration shall be made permanently accessible to stockholders.*”.

The reference in the law refers to the organisation responsible for the drafting of the code (rather than naming a specific code) which, as is the case for France, allows for flexibility in amending the code.

The Netherlands

Since December 2004, the Dutch CG Code has been designated by way of an order in council (*algemene maatregel van bestuur*), as a code of conduct under section 2:391, paragraph 5, of the Dutch Civil Code, which listed companies must refer to in their annual report. As a result, the ‘comply or explain’ mechanism is legally embedded.

Since 1 January 2007, under section 5:86 of the Financial Supervision Act (*Wet op het financieel toezicht*), Dutch institutional investors have been obliged, to include in their annual report or on their websites, a statement about their compliance with the principles and best practice provisions applicable to them.

As is the case in Belgium, the order in council refers expressly to the relevant code, in this case the 2008 Dutch CG Code. As a result, an amendment to the Dutch CG Code requires an update of the reference in law by adoption of a new order in council.

Since 2010, article 96 of the Belgian Company Code (the **BCC**) requires listed companies to provide a corporate governance statement in their annual report. The ‘comply or explain’ principle is also legally embedded in Belgium.

Via royal decree, the Belgian 2009 Code has been imposed as the reference code for listed companies. The Belgian 2009 Code is attached as an annex to the Royal Decree dated 6 June 2010 regarding the designation of the corporate governance to be complied with by listed companies.

The explicit reference to the Belgian 2009 Code complicates making amendments to the code. This topic will be addressed further in section 2.3(b).

2.2 *Monitoring of compliance with the corporate governance rules*

Flexibility and its soft law character are inherent aspects of corporate governance codes. Despite this, and perhaps because of it, compliance with the corporate governance rules needs to be monitored.

In the first instance, shareholders (should) play an important role in the monitoring of their investee companies, since they are the primary beneficiaries of corporate governance. However, it takes effort to monitor a company's application of the corporate governance codes. Often shareholders take little action.³

Also the boards and auditors play a role in the monitoring of a company. Indeed, since corporate governance codes are primarily addressed to companies, which are lead and directed by their board, boards have a central role in ensuring compliance with corporate governance codes. Legal provisions require boards to draw up a corporate governance statement.⁴ Also, the board must regularly evaluate the effectiveness of its governance policies.

In application of the Statutory Audit Directive, member states must impose the requirement for statutory auditors to formally evaluate compliance with the requirement to publish a corporate governance statement.⁵ In Belgium, the rather formal monitoring role of auditors consists of the review of the annual report, which includes the corporate governance statement. The auditor must verify whether the annual report (including the corporate governance statement) is complete, is in accordance with the annual accounts and does not contain any manifestly unreasonable, incorrect or inconsistent information. According to the Belgian Institute of Auditors, the auditor does not need to give a qualitative assessment on the content of the corporate governance statement.⁶

Market-wide monitoring (as opposed to company-specific monitoring by shareholders, boards, statutory auditors or other stakeholders) provides the relevant entities with information about compliance with (and therefore also the relevance and market acceptance of) the specific corporate governance provisions. This allows monitoring organisations to identify the need for further regulatory developments, be it for clarification, guidance or to update the existing provisions. Market-wide monitoring results may also reflect best practices and changes at an EU level, as well as at a national level. Consequently, market-wide monitoring results play an important role in the assessment of the need for a revision to an existing corporate governance code.

In addition to demonstrating the need to amend an existing corporate governance code, market-wide monitoring also enhances transparency. Moreover, the presence of a market-wide monitoring framework in itself may encourage companies to comply with the corporate governance rules, especially if the results of the studies are published with company names ('name and shame').

The monitoring activity can range from just an 'availability check' (declaration of adherence to a particular code or publication of corporate governance statements declaring which code provisions have been not followed) to a qualitative check (eg do statements of compliance and explanations of the deviations provide enough information to enable market actors to make informed judgements about a company's corporate governance practices?).⁷

³ European Commission Green Paper 'The EU corporate governance monitoring framework', Brussels, 5 April 2011, p. 19.

⁴ Eg in Belgium article 95 juncto article 96§2 of the Belgian Company Code.

⁵ Article 1.7 of Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings (the **Statutory Audit Directive**).

⁶ Circular of the Belgian Institute for Auditors (Omzendbrief 2011/10 van het Belgisch Instituut van Bedrijfsrevisoren)

⁷ Monitoring Study, p. 60.

The 2011 Green Paper on the EU Corporate Governance Framework (the **2011 Green Paper**) describes how market-wide monitoring, which is often informal and limited in scope, functions insufficiently. The 2011 Green Paper contains suggestions on how to optimise the market-wide monitoring (eg it suggests publishing the monitoring results or authorising the monitoring bodies to check whether the available information is sufficiently informative and comprehensive).⁸

“The functioning of the comply-or-explain mechanism could be improved by granting more monitoring powers to (independent) market-wide monitors.”

Monitoring Study

The subsequent Feedback Statement (the **2011 Feedback Statement**) shows, however, that most of the respondents were against giving monitoring bodies authority to check the informative quality of the explanations in the corporate governance statements. Likewise, most of the respondents were also against giving such monitoring bodies the authority to require companies to provide additional explanations.⁹

The 2011 Green Paper further states that, as regards the different practices developed by monitoring bodies in the various jurisdictions, there is great potential for improving and extending the current exchange of best practices.¹⁰

UK

In the UK, the securities regulator, the FSA, monitors compliance with the Listing Rules and DTRs, and the FRC monitors the UK CG Code and the Stewardship Code, and assesses their applications to UK businesses. The Conduct Committee of the FRC reviews annual reports and accounts of public (and large private) companies to check for compliance with the laws and it also monitors disclosures. In relation to its work involving annual reports and corporate reporting, the Conduct Committee carries out its responsibilities on behalf of the UK government. The Committee will consult with a company if its accounts are selected for review. If a company's accounts are considered to be defective in a material respect and revisions are necessary, this will be discussed with the company. If the company's directors agree to take remedial action, the Conduct Committee may issue a press notice, but will not further comment on or discuss its conclusions. If there is no press notice, the fact that an inquiry into a company was made will remain confidential. If necessary the Conduct Committee will apply to court to compel a company to amend its annual report and accounts.

The FRC is responsible for maintaining and updating the UK CG Code and the Stewardship Code.¹¹ It monitors developments and then reviews the codes and proposes updates at regular intervals, approximately every two years. Proposed changes are subject to public consultation. The last substantive review, conducted in 2009, resulted in the publication in 2010 of the current UK CG Code and the Stewardship Code, both of which reflect the lessons learned from the problems in the UK's financial services sector. The FRC has recently published new 2012 versions of both codes to reflect changes resulting from a recent review and public consultation during the summer of 2012.

More informally, accountancy firms such as Deloitte & Touche and Grant Thornton publish an annual report on the review and analysis of the governance practices of the UK's FTSE 350 companies.

France

In France, compliance with the French CG Codes is monitored by the AMF and by the associations that drafted the codes.

On the one hand, the AMF conducts a formal control and analysis of the annual reports of French listed companies. The AMF annually publishes a report on those companies chairmen's reports with respect to the corporate governance and the internal control procedures. In its

⁸ 2011 Green Paper, p. 19.

⁹ European Commission Feedback Statement 'Summary of responses to the Commission Green Paper on the EU corporate governance framework, Brussels, 15 November 2011, p. 18.

¹⁰ 2011 Green Paper, p. 19.

¹¹ In its report 'Developments in Corporate Governance 2011 – The impact and implementation of the UK Corporate Governance and Stewardship Codes', the FRC states: “[The FRC] will continue to monitor the quality of reporting by both companies and investors, including the areas highlighted in this report. Particular attention will be paid to the quality of explanations provided by companies that deviate from the UK Corporate Governance Code, with the aim of identifying and promulgating the type of information that should be included in a meaningful explanation.”

report, the AMF does not mention the names of companies and only prepares a statistical analysis. Even if the AMF recommends that some points be improved, it expresses no direct criticism of the companies subject to its monitoring.

The AMF review is made on the basis of a sample of companies (90 companies), some of which refer to the AFEP MEDEF Code and some (albeit fewer in number) of which refer to the Middlednext Code. The AMF issues recommendations based on this review. The AMF's observations can also lead to the legislator deciding to turn certain recommendations of the codes into legal provisions, and thus make them binding.

On the other hand, the AFEP together with the MEDEF conduct their own assessment on how the recommendations of their code are applied. The chosen sample consists of companies belonging to the SBF 120¹². The AFEP MEDEF report focuses on the progress made and on the most notable trends. The report aims to take a constructive standpoint: it contains examples of best practices and also the reasons given by the companies when they chose not to comply with certain recommendations.

In November 2010, the Lyon Business School (EM Lyon) in partnership with Middlednext, issued an exhaustive survey on the use of the Middlednext Code by those companies that refer to the Middlednext Code. The aim of the survey was to identify how these companies refer to the Middlednext Code and therefore, to better understand their characteristics, their system of governance and to seek ways to resolve certain identified issues.



Germany

In Germany, the federal government monitors the implementation of the code closely and intervenes if it is deemed necessary. Legal scholars also contribute to the monitoring of the code by conducting detailed studies on the implementation of the code.

The German CG Commission monitors the German GC Code to assess its continuing conformity with the law. It also monitors the German CG Code with regard to addressing, good or bad, corporate governance practices of, in particular, stock companies, which may be seen by the German CG Commission as advocating changes/supplementing the code. A low rate of implementation or compliance with specific rules is not in itself a reason for change. In its foreword, the German CG Code states: *“As a rule the Code will be reviewed annually against the background of national and international developments and be adjusted, if necessary”*. Those adjustments have so far taken place every year, except in 2004 and 2011.

The German securities regulator (the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*)) has no specific task or power to monitor of the implementation of the German CG Code.



The Netherlands

In the Netherlands, the market-wide monitoring function is, in principle, performed by the Monitoring Committee.

The Monitoring Committee, which was established for the first time in December 2004 and for the second time in July 2009, monitors the operation of the Dutch CG Code and its implementation by listed companies and shareholders. The Monitoring Committee analyses reports, assesses the informative quality of explanations and verifies the publication of results. Each year the Monitoring Committee reports on compliance with the Dutch CG Code on a ‘no names basis’.

The current Monitoring Committee consists of a chairman and six members (seven members is the maximum), assisted by an administrative secretariat. The chairman and members are appointed based on their expertise and experience in the field of corporate governance and are part of business industries, groups of shareholders, employee organisations, or are accountants or academics. The Minister of Finance, in consultation with the Minister of Justice and the State Secretary of Economic Affairs, appoints the members for an initial period not exceeding four years. The chairman and the members are eligible for reappointment for one further consecutive period. None of the members of the current Monitoring Committee were member of the previous Monitoring Committee.

¹² The SBF 120 (*Société des Bourses Françaises 120 Index*) is a French stock market index. The index is based on the 120 most actively traded stocks listed in Paris. It includes all 40 stocks in the CAC 40 index plus a selection of 80 additional stocks listed on the Premier Marché and Second Marché under Euronext Paris.

In 2010, 2011 and 2012 the Monitoring Committee commissioned various studies in the context of the Dutch CG Code. Such studies have been performed by the University of Utrecht, the University of Groningen, the Nyenrode Business University, and the Institute for Company Law (*Instituut voor Ondernemingsrecht*) of the University of Groningen/University of Rotterdam.

The Netherlands Authority for the Financial Markets (the **AFM**), supervises compliance with the standards for financial reporting and for the companies' financial statements. The AFM also supervises compliance with the rules governing the management board's report and the 'other information' section of the financial report. In this context, the AFM supervises the compliance with the Dutch corporate governance rules.

In Belgium, the market-wide monitoring of compliance with the Belgian 2009 Code is mainly performed by the CGC, the Financial Services and Market Authority (**FSMA**) and by the FEB and Guberna.

- The CGC's corporate purpose includes the contribution to the development of corporate governance among listed companies by, *inter alia*, regularly monitoring enforcement of the code. The CGC regularly publishes practical rules or guidance on the application of the Belgian 2009 Code.
- The FSMA monitors the disclosures imposed by the Belgian 2009 Code and the application of the 'comply or explain' principle. It publishes studies on the compliance with several disclosure requirements of the Belgian 2009 Code.¹³ In theory, it could publish the names of companies in this regard.
- The FEB and Guberna examine compliance with the codes and publish reports based on their findings.¹⁴

When analysing market-wide monitoring in the neighbouring countries, we find that often, the drafters of a corporate governance code play an important role in the monitoring of compliance with that corporate governance code.

Even though the drafters of the codes are obviously in a good position to analyse the monitoring results and swiftly respond to compliance issues by amending the codes, there are also possible drawbacks connected with assigning these two different roles (drafting and monitoring) to one entity. Indeed, it goes without saying that the drafting and monitoring roles potentially entail conflicting interests.

Therefore, a combination of monitoring by (i) the associations that drafted the codes and (ii) the securities regulators or the government may provide a rather effective framework. Such combined monitoring exists in the UK, Belgium, France and Germany.¹⁵

In addition to monitoring by the drafters of the codes and the securities regulators or government, various independent organisations (such as accountancy firms, universities, HR professionals) also take the initiative of performing their own monitoring studies. However, the scope of these studies is often limited to large companies.

Limited monitoring exercises, such as monitoring only large companies (eg BEL20 companies), may give a misleading view on compliance levels and an incomplete view on the reasons for non-compliance. Broad-scoped compliance monitoring studies commissioned by the drafters of the code, but performed by independent parties, such as universities, may be a better way of providing a comprehensive view of compliance.

Finally, the media may play also an influential role in monitoring companies' compliance with corporate governance. This role is bolstered by transparency and disclosure requirements.¹⁶

¹³ Cfr. (i) Study No. 38 on the compliance by the Belgian listed companies with new disclosure requirements imposed by the Belgian Corporate Governance Code 2009, dated December 2010 and (ii) Study No. 40 on the first corporate governance statements, follow-up study on Study No. 38, dated September 2011.

¹⁴ Cfr. (i) FEB and Guberna 2009 study on compliance with the 2004 Belgian Corporate Governance Code and (ii) FEB and Guberna 2011 study on compliance with the 2009 Belgian Corporate Governance Code by BEL20 companies. The studies concerned the formal compliance with the code.

¹⁵ In the Netherlands, the Monitoring Committee is responsible both for the monitoring of the compliance with the existing code and the subsequent revision of the code. However, it does not 'judge' its own work as none of the members of the current Monitoring Committee were member of the previous Monitoring Committee.

2.3 Amending and updating the corporate governance codes

One of the main advantages of soft law is its flexibility and adaptability (for example, in the event of changes in social or economic circumstances, EU or national legislation, or business practices). Indeed, in order to respect and ensure their authority and relevance, codes have to be (and generally are) regularly updated and reviewed. In practice, this often occurs as a last step in, and as result of, the monitoring process. However, with the move towards the legal embedment of the codes in several EU member states, the ability to amend the codes has become less straightforward and some of the flexibility of the soft law approach may be lost.

(a) Amendment procedures

In the majority of the EU member states, we observe two characteristics of the revision process: (i) it is often the authors of the codes who are responsible for revising and updating the codes; and (ii) there is no formal revision procedure. The ad hoc arrangements seem to be effective, *inter alia* in view of the abovementioned flexibility of the codes but also in view of the desire to avoid amending the codes unnecessarily often.

The revision procedures of the different countries all demonstrate their own features and characteristics.

UK

In the United Kingdom, normally both the UK CG Code and the Stewardship Code are updated every two years to ensure that they stay relevant. The FRC performs its review through dialogue with those who prepare accounts, board members, lawyers, actuaries, and accountants, as well as investors. Proposed amendments to either code will be the subject of public consultation and are subject to extensive dialogue with the market. The FRC has the ability to issue amended versions of either code or to issue further guidance in implementing the codes where deemed necessary. Amendments are ushered in with sufficient lead time so as to enable companies to make appropriate arrangements.

Since 2003 the UK CG Code has been updated four times. The Stewardship Code has, since its first publication in 2010, been updated once.

France

In France, there is no formal mechanism to update or revise the codes. Nevertheless, MEDEF and AFEP, regularly update and complete their recommendations regarding the AFEP MEDEF Code, taking new legislation and the market's needs into consideration.

The AFEP MEDEF Code has been updated four times. The Middlednext Code has not yet been updated.

Germany

The German CG Commission is responsible for updating the German CG Code. In this respect, it reviews the code regularly, normally annually, and amends it, if necessary. Since 2002, the German CG Code has been amended eight times. Currently the ninth version of the code applies.

In 2012, the German CG Commission started to involve the public in the amendment process by issuing draft amendments and asking for comments. Final amendments, if any, are made public by the German CG Commission via publication of the complete text of the amended code, normally in both a clean and marked-up version. Prior to publishing it in the official section of the Federal Gazette, the Federal Minister of Justice reviews the new version with respect to its conformity with the law. Once published, the new version of the German GC Code

¹⁶ Klaus J. Hopt (Max Planck Institute and European Corporate Governance Institute (ECGI)), *Comparative Corporate Governance: The State of the Art and International Regulation*, January 2011, p. 69

becomes 'official' authority for future 'comply or explain' declarations. The Federal Minister of Justice cannot, by himself, alter the code or any amendment thereof. The Federal Prime Minister of Justice can only decide not to publish the new version in the Federal Gazette (which means that the previous version remains relevant for the 'comply or explain' declarations to come) or ask the German CG Commission to review its amended version once again to ensure legal conformity.



The Netherlands

Two of the Monitoring Committee's main tasks are: (i) to keep national and international developments in corporate governance under general review; and (ii) to indicate whether there is any gap or vagueness in the Dutch CG Code. There is no predetermined frequency for conducting revision procedures, nor is there a predetermined timing for a revised code to be published.

As a preliminary step in the revision process, the Monitoring Committee reports annually to the Minister of Finance, the Minister of Justice and the State Secretary of Economic Affairs on possible recommendations, including its comments on the application of the Dutch CG Code, and on the adequacy of the code in the context of social and international standards and practices. However, the Monitoring Committee does not have any legislative power nor a mandate to amend the Dutch CG Code. Therefore, its comments and recommendations do not automatically become part of the code, but may be used as an informal guideline for companies and shareholders. The code can only be amended upon ministerial order.

The explanatory notes to the Order constituting the Monitoring Committee also state that proposed revisions to the Dutch CG Code will be subject to an adequate period of public consultation.

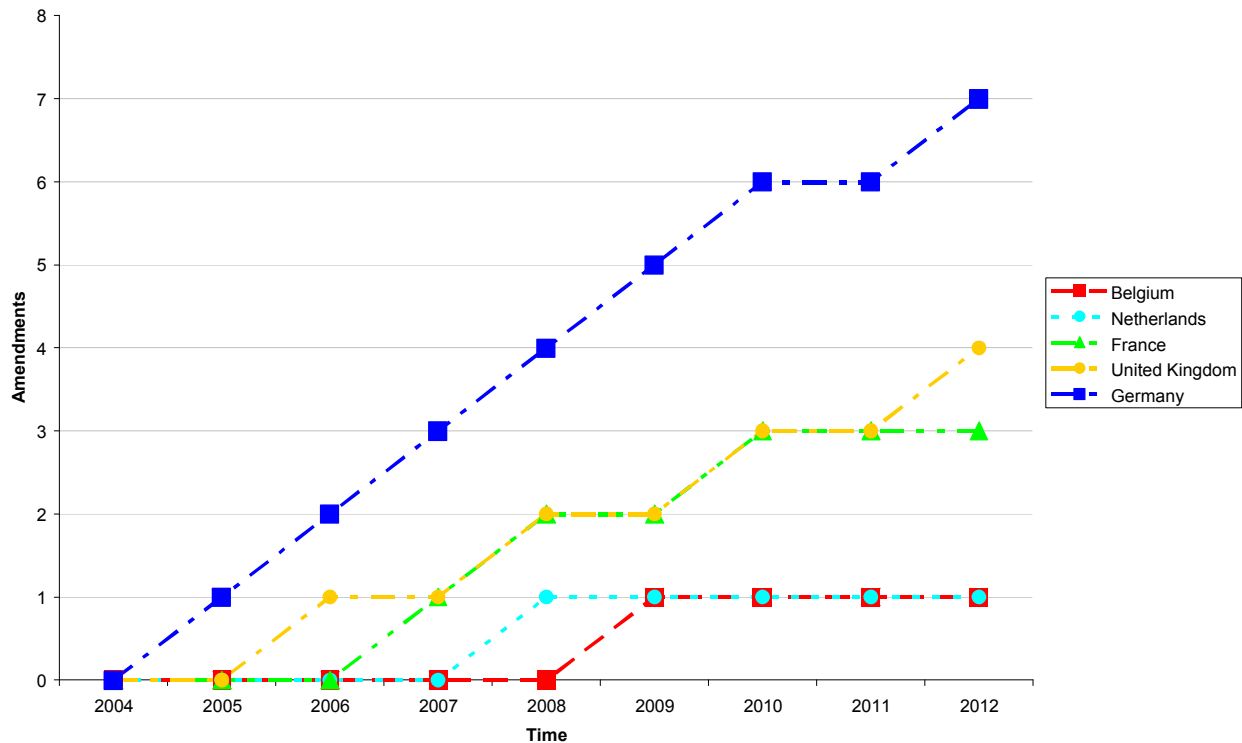
In light of the division of tasks between drafters, revisers and monitoring instances, the explanatory notes to the Order constituting the Monitoring Committee refer to an intention to establish an ad hoc committee, in addition to the Monitoring Committee. This ad hoc committee could evaluate the Dutch CG Code at the appropriate time and propose revisions, if required, based on the comments of the Monitoring Committee following its annual review.

However, this proposed ad hoc committee has never been established. Instead, the latest revision to the Dutch CG Code was made in December 2008 by the Monitoring Committee at the request of the National Federation of Christian Trade Unions in the Netherlands, Eumedion, the Federation of Dutch Trade Unions, the Netherlands Centre of Executive and Supervisory Directors, NYSE Euronext, the Association of Stockholders, the Association of Securities-Issuing Companies, and the Confederation of Netherlands Industry and Employers. The government endorsed this request.

The Belgian 2009 Code is modified by its author, the CGC, on an ad hoc basis. The aim of the CGC is to contribute to the development of corporate governance among listed companies by, *inter alia*, submitting suggestions for amendments, amending the code or issuing positions on any regulatory initiative or other initiative pertaining to corporate governance. The CGC makes the amendments on the basis of those proposals receiving large public and professional support, derived from consultations.

Since its last (and only) update in 2009 the code has been legally embedded, which implies that an amended code would need to be recognised as reference code by royal decree. As the code has not yet been amended since becoming legally embedded, it is not yet clear how public authorities will be involved in the amendment procedure (see further under section (b)).

The table below shows the frequency of revisions of the codes in the studied jurisdictions, since 2004.



With only one amendment (which is below average in the EU), the Belgian corporate governance code has remained relatively stable since its inception. But a few substantive revisions may be more 'palatable' than frequent minor updates.

(b) The impact of legal embedment of corporate governance rules on the dynamics of making amendments to the corporate governance codes

As illustrated above, in France and the United Kingdom, the national law refers (indirectly) to the codes as updated and amended by the relevant organisations. This gives the relevant national organisation the possibility to update and amend codes, without the intervention of the legislator or the government.

In Belgium, however, pursuant to the advisory opinion of the council of state (*de Raad van State*), the Royal Decree designating the corporate governance code to be complied with by listed companies dated 6 June 2010, refers specifically to the Belgian 2009 Code. This means that a new royal decree would, in principle, need to be issued every time the code is updated or amended for that amended code to replace the Belgian 2009 Code as reference code for the purpose of legal embedment. Consequently, amendment procedures in Belgium appear to be less flexible than the French or UK procedures. The examples of France and the UK are therefore less relevant for Belgium in this respect. The situations in Germany and the Netherlands do offer some interesting insights.

Germany

In Germany, any changes to the German GC Code, resolved by the German Corporate Governance Commission, need to be published by the Federal Minister of Justice in the official section of the Federal Gazette in order to become 'official authority' for future 'comply or explain' declarations. This seems to be in line with the procedure in Belgium. However, no government decree is required: the decision of the Federal Minister of Justice to order the publication of the new version of the code is sufficient. So far, in practice, this publication has followed within weeks of any amendment of the code resolved by the Commission. It should be noted that the Federal Minister of Justice would only refuse to publish the code if it was not in conformity with the law.

 The Netherlands

As described above, the Dutch CG Code is designated by way of an order in council (*algemene maatregel van bestuur*), as a code of conduct under section 2:391, paragraph five, of the Dutch Civil Code. The order in council refers explicitly to the 2008 Dutch CG Code. This means that every time the Dutch CG Code is amended, a new order in council needs to be adopted. The procedure for adoption is as follows:

- preparation of a draft order in council by the Ministry of Justice;
- discussions of the draft order in the cabinet (*ministerraad*);
- submission of the draft to the Upper Chamber (*Eerste Kamer*) and the Lower Chamber (*Tweede Kamer*) (this is the so-called ‘preliminary scrutiny procedure’ (*voorhangprocedure*) during which both the Upper Chamber and the Lower Chamber have four weeks to propose amendments to the draft);
- submission of the draft to the Council of State (*Raad van State*) for advice; and
- publication of the order in council in the Bulletin of Acts and Decrees (*Staatsblad*).

As set out above, the legal embedment of specifically the Belgian 2009 Code, henceforth requires for future amendments of the code not only a decision of the CGC, but also in principle a recognition of the new code as reference code by royal decree. This complicates the amendment procedure and, to a certain extent, deprives the code of one of the main features of its soft law character, namely its flexibility.

However, the CGC may, within the scope of its corporate purpose, issue practical rules or guidance documents, for example clarifying or interpreting the code. The CGC may also recommend the application of corporate governance practices other than those included in the corporate governance code.¹⁷ These practical rules, guidance documents or other corporate governance practices are not legally embedded and consequently do not need to be recognised by royal decree. However, this presupposes that the legal provisions and the code's provisions are respected (as they rank higher in the normative hierarchy¹⁸), and these practical rules, guidance documents or other corporate governance practices go beyond those legal provisions or the code's provisions. The 'comply or explain' principle does not in principle apply to these rules and practices.

(c) Categories of reasons for amending or updating the corporate governance codes

Generally speaking, there are four main reasons for amending or updating existing corporate governance codes:

- to implement or adapt to European directives, regulations or recommendations;
- to avoid inappropriate discrepancies between the code and the law (eg following a shift from soft law to hard law);
- to stay in line with the best practices, and remain progressive; and
- based on practical experience: to clarify, complete, add detail, add guidance, and remedy interpretation issues.

¹⁷ Article 96, 1°, 2 Belgian Company Code.

¹⁸ With the legal embedment of the codes, we distinguish a normative hierarchy of three levels:
 (1) positive law, composed of legal and regulatory provisions, which are compulsory, unless the provision allows a derogation;
 (2) the principles and provisions of the Belgian 2009 Code, which are expected to be complied with, it being understood that the company can deviate from some provisions if it indicates from which provisions it deviates and provides a substantiated reason for the deviation in its corporate governance statement;
 (3) other corporate governance practices, which the company must indicate in its corporate governance statement.

3. Content of corporate governance rules: parameters for the consideration of a revision of the Belgian 2009 Code

3.1 EU influence on corporate governance dynamics

The corporate governance regulatory framework at the European level consists of a number of Directives and Recommendations.

The Directives on shareholders' rights¹⁹, audits²⁰, transparency of listed companies²¹, market abuse²² and takeovers²³, provide a minimum EU corporate governance framework.²⁴ EU Directives lay down certain end results that must be achieved in every member state. National authorities have to amend their laws to meet these goals, but are free to decide how to do so. Each Directive specifies the date by which the national laws must be amended. Directives are indeed used to bring different national laws into line with each other.²⁵ However, taking into account the different legal traditions and cultures, there is a broad consensus in the EU that, in principle, national law on corporate governance should not be subject to large-scale harmonisation.²⁶

In addition to the Directives, there are also Recommendations which provide guidance to the national legislators and drafters of corporate governance codes.

The European Commission (the EC) has issued several Recommendations in the field of corporate governance, in particular on the independence of non-executive directors and board committees²⁷, and on remuneration of directors²⁸. Commission Recommendations are not binding, however, through legislation or best practice rules based on the 'comply and explain' principle, the member states are invited to take the necessary measures to promote the application of the Recommendations by a certain date. The objective of the EC is to promote greater convergence within the EU towards best practices on the topics covered by the Recommendations (such as directors' remuneration and non-executive directors). The EC considered Recommendations to be more suitable than Directives for these topics, so as to allow member states to take due account of national corporate governance traditions and practices.²⁹

“The corporate governance framework for listed companies in the European Union is a combination of legislation and ‘soft law’, including recommendations and corporate governance codes. 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.”

2011 Green Paper

¹⁹ Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies

²⁰ Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 amending Council Directives 78/660/EEC on the annual accounts of certain types of companies, 83/349/EEC on consolidated accounts, 86/635/EEC on the annual accounts and consolidated accounts of banks and other financial institutions and 91/674/EEC on the annual accounts and consolidated accounts of insurance undertakings

²¹ Directive 2004/109/EC of the European Parliament and of the Council 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

²² Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse)

²³ Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on takeover bids

²⁴ <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/404&format=HTML&aged=0&language=en&guiLanguage=en>

²⁵ http://ec.europa.eu/eu_law/introduction/what_directive_en.htm

²⁶ Report of the Reflection Group On the Future of EU Company Law, Brussels, 5 April 2011. This contrasts with the EC's recent position on audit requirements stating a clear preference for 'hard law' harmonisation (see 3.3(e) below).

²⁷ Commission Recommendation 2005/162/EC

²⁸ Commission Recommendation 2004/913/EC and Commission Recommendation 2009/385/EC

²⁹ European Commission Recommendations on directors' remuneration and the role of non-executive and supervisory directors - frequently asked questions, October 2004

Belgium has implemented the EU Directives on corporate governance and is generally in line with most of the Recommendations.

In some corporate governance domains, Belgium has clearly gone further than what is required by the EU regulator. For example, in the field of remuneration of directors, Belgium has an extensive set of legal provisions which make it a frontrunner in this respect.

However, we have also identified a small number of topics on which the Belgian 2009 Code slightly differs from the EC Recommendations:

- the frequency of the evaluation of the performance of the board of directors (annually (EU), every two or three years (Belgium)) and of the review by the board of directors to identify areas where directors need to update their skills and knowledge (annually (EU), not specified (Belgium));
- Belgian corporate governance rules do not reflect the EC Recommendation which states that the remuneration committee should ensure that remuneration of individual executive or managing directors is proportionate to the remuneration of other executive or managing directors and other staff members of the company;
- Belgian corporate governance rules do not reflect the EC Recommendations which state that the remuneration policy should summarise and explain the company’s policy with regard to the terms of the contracts of executive directors (including but not limited to the duration of the contracts, the applicable notice periods, etc).

However, it is inherent to the legal nature of these Recommendations that jurisdictions choose to adopt different approaches.

Overall, Belgian law and the Belgian 2009 Code are characterised by an above average implementation of EU requirements. The few departures from the Recommendations are not material. In our view, there is currently no need stemming from the EU level, which urgently requires an amendment of the Belgian 2009 Code.

Further changes to the European corporate governance framework are, however, expected shortly. In April 2011, the EC issued the 2011 Green Paper launching a public consultation on possible ways to improve the corporate governance framework in Europe. The results of the public consultation were published in November 2011. The European Parliament urged the EC to present an action plan indicating the way forward after the consultation. The European Parliament wants this action plan to outline short-, medium- and long-term initiatives to improve the regulatory framework for EU company law.³⁰

A communication on the action plan “*European Company Law and Corporate Governance – a modern legal framework for sustainable and competitive companies*” is currently expected for the end of 2012. According to a ‘roadmap’ concerning this initiative, dated April 2012, the communication will announce measures intended to address several underlying reasons for the lack of appropriate shareholder engagement, such as the short-termism of the financial markets, problems arising from the principal-agent relationship between investors and their asset managers, conflicts of interests, the role of proxy agents and difficulties with shareholder cooperation. It will also look at how to improve the transparency of remuneration policies and related-party transactions, and the role shareholders may have regarding these issues. Moreover, it will consider ways to improve the quality of information provided by listed companies regarding corporate governance.³¹

³⁰ European Parliament resolution of 14 June 2012 on the future of European company law (2012/2669(RSP))
³¹ http://ec.europa.eu/governance/impact/planned_ia/docs/2012_market_002_action_plan_corporate_governance_and_company_law_en.pdf

The EC has stated from the outset of the consultation that any future legislative or non-legislative proposal will be accompanied by an extensive impact assessment which will take into account the need to avoid putting a disproportionate administrative burden on companies.³²

Some jurisdictions at the forefront, such as the UK, do not await the EU level amendments. For example, the FRC believes that targeted and proportionate action to improve practice at a national level, may help alleviate the pressure calling for more prescriptive action at the EU level. The FRC also notes that, judging by the usual timetable for introducing EU requirements, the new EU requirements would not need to be implemented until, at the earliest, 2014 for those requirements relating to audit committees and auditor appointments, and not until 2015 for those requirements relating to other aspects of corporate governance.³³

However, even though it may be important to be a frontrunner and to be perceived as progressive (and even though Belgium is also progressive in several areas), the FRC's ambition to alleviate the pressure for more prescriptive action at EU level by issuing UK soft law/self-regulation, may not be as effective or realistic for Belgian self-regulation. Furthermore, if the Belgian 2009 Code is amended ahead of the EC amendments, the prospect of EU level action may overlap (or even be inconsistent) with some of the issues addressed in the amended code. This could be an argument for deferring changes to the Belgian 2009 Code until the EC amendments are known.

Through Directives and Recommendations, which constitute the EU corporate governance framework, rules are established which should or may form a part of the national corporate governance frameworks. The Belgian corporate governance framework is in line with the existing Directives and does not present material deviations from the EU soft law framework (ie from the Recommendations).

Many changes in the field of corporate governance are expected at the EU level. It is likely that at least some of these changes will be included in directives or regulations, and will therefore require implementation in national hard law.³⁴ Amending the Belgian 2009 Code to address certain issues now, ahead of the proposed changes at EU level, is unlikely to prevent new hard law and may even complicate issues further by requiring further amendments to the code in order to bring it into line with the new legal provisions.

In our view, there is currently no need stemming from the EU level, which urgently requires an amendment of the Belgian 2009 Code. Belgium may want to wait for EU initiatives in this area.

3.2 *Legislative mechanics*

In all jurisdictions certain corporate governance related topics are included in the law. Some rules are inserted in the law from the outset, as a result of EU influence, or triggered by public debate. Other rules have moved from soft law to hard law. The possibility to 'explain' vanishes with this shift from soft law to hard law. This indeed implies better compliance with the respective rule.³⁵

The shift from soft law to hard law may result in overlap or even in inconsistencies between the code and the legislation.

³² <http://www.europarl.europa.eu/oeil/popups/summary.do?id=1163423&t=e&l=en>


³³ FRC, *Consultation Document: revisions to the UK Corporate Governance Code and Guidance on Audit Committees and associated documents*, April 2012, p. 2.

³⁴ See section 3.3(e) below on EC's emphasis on hard law for audit matters.

³⁵ As suggested by the FSMA: Study n.38 on the compliance by the Belgian listed companies with new disclosure requirements imposed by the Belgian Corporate Governance Code 2009, dated December 2010, p 26.

Some jurisdictions, such as Italy, have amended their codes to address overlaps with certain legal provisions.³⁶ However, in general, authors of the codes are not inclined to rush to amend the codes following a legislative change affecting certain matters already covered by the code.

Indeed, legislative changes relating to corporate governance do not necessarily require an amendment of a corporate governance code. Provisions of the code may remain relevant if they provide more detailed guidelines than the legal provisions. Also a pure overlap may enhance the readability and coherence of the code. If, however, the legal provisions are inconsistent with the code, the code will need to be amended.

 The United Kingdom


Where provisions of the code overlap with legal provisions, the UK CG Code indicates such fact in the footnotes. Areas of overlap are also summarised in an annex to the code.

“For the sake of the Code’s readability and its internal coherence the Committee has decided that any overlap between the legislation and the Code is inherent in the Code’s function and need not necessarily result in amendments to the Code.”

 Germany

In Germany, changes in the law affecting recommendations or suggestions of the German CG Code will be timely reflected in the wording of the German CG Code: normally the German CG Code does not delete those recommendations/suggestions, which have become hard law, but instead alters the wording of the code to clarify the binding character of the provision.

The preamble of the Dutch CG Code

 France

In France, there is some overlap between the law and French CG Codes since the French legislator has sometimes inserted in the law, provisions which were previously recommended in the codes and, as a general rule, this integration in the law has not been accompanied by changes to the codes.

 The Netherlands

The preamble of the Dutch CG Code states: *“For the sake of the Code’s readability and its internal coherence the Committee has decided that any overlap between the legislation and the Code is inherent in the Code’s function and need not necessarily result in amendments to the Code, also because the Code may contain provisions that supplement the statutory provisions. If a principle or best practice provision corresponds with a statutory rule, this may mean that a company or shareholder is not allowed to depart from the relevant provision, not even when reasons are given.”*

 Italy

The preamble of the Italian corporate governance code (the **Italian CG Code**) states: *“In case of either laws or regulations that are inconsistent with certain recommendations of this Code, no information is required on the omitted or partial implementation of such recommendations.”*

With respect to Belgium, there are some differences between the law and the code regarding similar corporate governance topics^{37, 38}. These differences result inter alia from recent legislative action.

³⁶ The Italian CG Code, for example, was amended in December 2011, *inter alia* to repeal overlaps with certain legal provisions.
³⁷ Eg the Belgian 2009 Code only imposes disclosure requirements concerning the evaluation period, whereas the Belgian Company Code also requires companies to spread the remuneration over time.
³⁸ A useful overview is made available on the website of the CGC setting out notes highlighting the impact of recent legislation on the Belgian 2009 Code.

If the code provision is stricter, it retains its relevance. However, it may lose some of its legitimacy since 'explaining' has become easier: companies will refer to having complied with the law even if not fully satisfying the code.

If the code provision is less strict, the code provision is no longer relevant.

Examples of differences include:

- The Belgian 2009 Code states that non-executive directors should not receive a variable remuneration, whereas the Belgian Company Code allows a variable remuneration for non-executive directors if approved by the general meeting of shareholders. In this case the code is stricter and thus remains relevant (especially in view of the obligation to explain departures from the code).
- The Belgian 2009 Code requires that at least a majority of the audit committee's members are independent, whereas the law only provides that at least one member must be an independent director. Also on this point the code is more stringent and thus remains relevant.
- The descriptions, given in the law and in the Belgian 2009 Code, of the reasons which directors may invoke for not responding to shareholders' questions at the general meeting differ slightly. The difference in wording may (albeit exceptionally) lead to confusion and is in any event not ideal. In explaining departures from the code, companies are more likely to refer to the legal wording rather than the wording of the code.
- The Belgian 2009 Code provides that the level of shareholding for the submission of proposals by a shareholder to the general shareholders' meeting should not exceed 5% of the share capital, whereas the Belgian Company Code states since 2010, that shareholders jointly holding at least 3% of the share capital of the company can submit proposals to the general shareholders' meeting. Here, the requirement of Belgian 2009 Code is less strict, than the law is and has therefore become obsolete.

Even though there are some imperfections in the overlap between the Belgian 2009 Code and legal provisions, these imperfections, in our view, do not require an immediate amendment of the code. We would recommend rectifying the imperfections in a subsequent change, but currently they merely affect the readability of the Belgian 2009 Code. Indeed, we subscribe to the trend mentioned above of a few important updates, rather than frequent minor amendments.

In general, we find that there are two major concerns regarding overlaps between legal provisions and a corporate governance code, ie the need (i) to avoid inappropriate inconsistencies between legal provisions and the code and (ii) to ensure the readability and practicability of the corporate governance code for its users (eg foreign investors). The clarity and accessibility of the existing corporate governance framework is indeed affected by the dispersion of the corporate governance rules over hard law and soft law.

With the enactment of corporate governance rules in law, overlaps arise between legal provisions and provisions of the corporate governance codes. These overlaps are acceptable and may even be desirable as long as (i) there are no inconsistencies between legal provisions and code's provisions; and (ii) the corporate governance code is still readable and practicable.

The Belgian 2009 Code includes recommendations that are sometimes more stringent and sometimes weaker than the law. In the latter case, the relevance of the provision is questioned (and more generally, the authority of the code is fettered). Technically, though, in view of the overlap between soft law and hard law we see no urgent need to amend the Belgian 2009 Code, but would recommend rectifying some inconsistencies in a subsequent change.

3.3 Best practices: trends

The third possible reason for amending a corporate governance code is to stay in line with best practices and to remain progressive. This is obviously a very broad motive. Therefore, we have focused on: (i) the main recent and envisaged changes to the codes in the UK, France, Germany, Italy and the Netherlands; and (ii) five themes that were proposed by the CGC.

The main trends which can be distilled from the overview in the first section below on recent and envisaged changes in our neighbouring countries relate to shareholder engagement; avoiding a box-ticking application of the corporate governance codes, with qualitative ‘explaining’ and behaviour rules; the role of the audit committee and the external auditor; director’s remuneration; independence of directors; and board room diversity.

In the second section, we will focus on the three first trends (the role of shareholders; rules of conduct for directors; and the role of the audit committee vis-à-vis the external auditor), as well as on (i) the question whether corporate governance rules need to be specifically adapted to the size of the company; and (ii) the key role of the chairman of the board ensuring an effective debate in the increasingly complex corporate governance environment.

This study does not deal in great detail with certain hot topics such as directors' remuneration or gender diversity, nor with the independence of directors. The Belgian corporate governance framework (including soft law and hard law) on these topics seems to be quite well positioned when compared with the studied jurisdictions. Therefore the topics proposed by the CGC seem indeed the more interesting ones for further analysis in the scope of this study.

(a) Recent and envisaged changes in Belgium’s neighbouring countries

UK

In 2011, the FRC consulted on changes to the UK CG Code relating to boardroom diversity. The changes require companies to disclose their policy on boardroom diversity and how it is being implemented. These changes (which only relate to disclosure and not to quota) were announced in October 2011 with implementation effective from 1 October 2012.

In 2012, the FRC consulted on further changes to the UK CG Code and the accompanying Guidance on Audit Committees, as well as the Stewardship Code. The changes from both the 2011 and 2012 consultations are incorporated in the 2012 versions of the UK CG Code, the Stewardship Code and updated Guidance on Audit Committees and apply to companies with financial years starting on or after 1 October 2012.

The 2012 changes (other than those relating to boardroom diversity) to the **UK CG Code** include: (i) asking boards to set out in the annual report the reasons why they consider the annual report to be fair, balanced and understandable; (ii) expressly extending the remit of the audit committee to include advising the board on the issue referred to in (i); (iii) encouraging more meaningful reporting by audit committees, including the process of appointing the external auditor; (iv) providing more guidance on informative explanations that should be provided to shareholders when a company chooses not to comply with the code; and (v) requesting FTSE 350 companies to put the external audit contract out to tender at least every ten years. The FRC recognises there is the prospect of action at the EU level that may overlap with some of the issues addressed in the UK CG Code. However, it has decided not to defer the changes, but hopes that “*targeted and proportionate action to improve practice at national level may help to alleviate the pressure for more prescriptive action at EU level*”.

" The FRC's review of the implementation of the Code in 2011 reinforced the two principal conclusions reported in the preface to the 2010 edition. First, that much more attention needed to be paid to following the spirit of the Code as well as its letter. Secondly, that the impact of shareholders in monitoring the Code could and should be enhanced by better interaction between the boards of listed companies and their shareholders. The UK Stewardship Code, which provides guidance on good practice for investors, should be seen as a companion piece to this Code. "

Preface of the 2012 UK CG Code

The FRC has updated its **Guidance on Audit Committees**, partly to reflect the changes on audit in the UK CG Code. The changes to the auditing standards are mainly directed at: (i) enhancing auditor communications by requiring the auditor to communicate to the audit committee information that the auditor believes the committee will need in order to understand the significant professional judgements made in the audit; and (ii) extending auditor reporting by requiring the auditor to report, by exception, if the board's statement of why the annual report is fair, balanced and understandable is inconsistent with the knowledge acquired by the auditor in the course of performing the audit, or if the matters disclosed in the report from the audit committee do not appropriately address matters communicated by the auditor to the committee. As regards auditing, a key objective is for greater transparency in the way audit committees discharge their responsibilities in relation to the integrity of the annual report. Audit committees play an important role regarding auditor independence. The changes will extend the remit of, and the reporting by, the audit committee.

The changes to the **Stewardship Code**, mainly concern (i) reflecting the changes made to the UK CG Code and (ii) clarifying several concepts and issues including: what is meant by 'stewardship'; the respective responsibilities of asset owners and asset managers; recognition that investors may want to be made insiders; encouraging investors to give an indication of the sorts of circumstances in which they might participate in a collective engagement; and asking investors to disclose their policy on stock lending and on whether they recall lent stock for voting purposes. The amendments are not substantive, they are more to do with reinforcing the code, where necessary, rather than fundamentally changing it. The FRC has recognised that in practice the quality of engagement and reporting remains variable. Consequently, the FRC wanted to make some improvements to encourage greater transparency and take into account lessons learned during the initial implementation of the code.

The changes made to both codes by the FRC fall within the second and fourth type of categories of reasons described under section 2.3 (c) above, and are aimed at improving practice at the national level.

France

In accordance with the announcements made in the French Ministers Council of 13 June 2012, the French government plans to submit a draft bill to parliament on the supervision of practices regarding directors' remuneration and the modernisation of governance of French companies. In this perspective, the French Treasury has launched a consultation about number of matters and issues on which the involved parties' opinion is being sought.

The questions raised in the consultation paper focus on three main topics:

- The framework for variable remuneration paid to directors (stock options, bonus shares, 'golden hello' and 'golden parachute' provisions, payments due in the context of the application of non-compete clause, complementary pensions etc).
- The rules of governance for determining directors' remuneration (transparency policy, the role of governing bodies as regards the remuneration policy – for instance, should the implementation of a remuneration committee be compulsory?) and the level of involvement that shareholders should have in determining the remuneration policy.
- Other provisions of corporate governance not expressly related to remuneration (proxy advisers, related-party agreements, and multiple directorships).

In addition, several questions are raised with regard to the scope and the nature of the contemplated measures:

- To which categories of companies (listed companies, companies exceeding a certain size) and directors (executive directors, non-executive directors) should the measures apply?
- Should the contemplated measures be included in the draft bill (hard law) or would be it preferable to complement the existing governance codes (soft law)?
- Should (some or all of) these new measures be binding and, if yes, how?

Responses were expected by 15 September 2012.



Germany

The German CG Code is regularly reviewed and consequently amended to reflect changes in the law or best practice in corporate governance. The latest review took place earlier this year (2012) and the new version of the German CG Code following that review was issued in the Federal Gazette in June 2012, thus making it to the official reference for the annual ‘comply or explain’ declaration to be issued by the executive and the supervisory board of German listed companies. The main changes in content made to the code were as follows:

- Permitted payments to executive board members in the event of early termination have been further regulated.
- The tasks of the audit committee have been described more precisely.
- The German CG Code now puts even more emphasis than before on having an adequate number of independent supervisory board members. Independence is now defined as absence of any personal or business connection which may lead to a long lasting material conflict of interest. Together with its voting recommendations for future members of the supervisory board, the board must disclose to the annual meeting any personal or business connections that a candidate may have with the enterprise, its boards or major shareholders, if any.
- The recommendations regarding the remuneration of executive board members no longer contain a specific recommendation to base a part of the remuneration on the development of the company. However, if such specific payment is promised it is recommended to base it on the sustainable development of the enterprise.

Since the German CG Code has been amended every year – except 2004 and 2010 – since it was first issued in 2002, the commission is under pressure from the private economy to restrict future changes to those absolutely necessary and in particular to restrict the frequency with which new codes are issued. It is therefore anticipated that there will not be further decisive alterations to the German CG Code in the coming two years.

Nevertheless, possible changes may regard:

- Further guidance on how to structure the remuneration for members of the executive board in order to restrict/eliminate excessive pay, which is the subject of severe criticism by the public.
- Responding to pressure aimed at achieving a quicker implementation of a more diverse structure in the boards and the upper management, especially raising the number of female board members. Given public pressure, the German legislator may be even quicker than the commission in addressing this issue. It is possible that the legislator may, by law, initiate a quota system for the executive board or the supervisory board or both.
- If enacted by the EU, the EU regulation regarding statutory audit for public-interest companies will be reflected promptly in the German CG Code. Many aspects of the proposed regulation itself have been criticised by the private economy and auditor organisations.
- The commission tends to further specify the number of and the degree of independency of supervisory board members, and had issued precise proposals on this issue when dealing with the 2012 revision of the German CG Code. Following a storm of protest it has withdrawn these proposals, but new proposals on this issue seem likely.

The [German Corporate Governance] commission is under pressure from the private economy to restrict future changes to those absolutely necessary and in particular to restrict the frequency with which new codes are issued.



Italy

With respect to the Italian CG Code, recent changes (dated 2010 – 2011) mainly concern the following topics:

- The composition of the board of directors: (i) recommending that all directors should be adequately competent and professional; (ii) specifying the minimum required number of independent directors; (iii) clarifying the role of the lead independent director and supplementing the number of cases requiring his or her appointment; (iv) discouraging cross-directorship situations among chief executive officers of companies not belonging to the same corporate group; (v) providing the possibility to adopt staggered board mechanism.
- The role and operation of the board of directors: (i) clarifying that the main objective of the board of directors consists of creating value for the shareholders over a medium- to long-term period and, defining the risk profile, consistently with the company's strategic objectives; (ii) strengthening the provisions concerning the self-assessment by the board of directors; (iii) clarifying the functions of the chairman of the board of directors with respect to the supply of pre-meeting information; (iv) allowing the chairman of the board of directors to request that the executives of the company in charge of the relevant management areas related to the board agenda attend the meetings of the board to provide supplemental information on the items on the agenda.
- Organisation and functions of the internal committees of the board of directors: (i) providing that the activity of the internal committees is coordinated by a chairman and that the chairman of the control and risk committee and of the remuneration committee is an independent director; (ii) providing the possibility, subject to certain conditions, not to establish the internal committees and reserving the functions of the relevant committees to the board of directors; (iii) providing the possibility that the internal committees are made up of two directors only (instead of at least three) when the board of directors is made up of no more than eight (formerly five) members; and (iv) recommending the establishment of the nomination committee.
- Remuneration of the directors: (i) recommending determining, on the proposal of the remuneration committee, a remuneration policy for the executive directors, other directors having particular offices and key management personnel; and (ii) specifying the criteria to be considered for determining the remuneration policy.
- Rationalisation of the internal control and risk management system: (i) clarifying the functions and responsibilities of the various bodies involved in the internal control and risk management system and requiring the adoption of coordination methods between the various bodies; (ii) stressing the importance of the internal audit function and, in order to preserve the autonomy of the person in charge of the internal audit function, providing that any decision concerning the appointment, revocation and remuneration of that person must be adopted by the board of directors subject to the favourable opinion of the control and risk committee and after hearing the board of statutory auditors; (iii) providing that the internal audit function must be carried out on the basis of an audit plan, to be prepared by the person in charge of the relevant function and approved by the board of directors, based on a structured analysis and ranking of the main risks.

The above mentioned changes to the Italian CG code are for the following reasons:

- To update the code in light of various changes in Italian laws and regulations having incorporated or superseded various provisions of the code in order to remove overlapping or out-of-date provisions (eg on market abuse, related party transactions, appointment of directors and statutory auditors).
- To simplify the code in order to facilitate listing and compliance with the provision of the code by small and medium sized companies (eg the possibility, subject to certain conditions, not to establish the internal committees of the board of directors).
- To adapt the code in line with the developments in international best practices (eg strengthening the role of the board of directors and of the independent directors, carrying out a rationalisation of the internal control system).

The Netherlands

There are currently no envisaged changes to the Dutch CG Code.

The last revision to the Dutch CG Code was made in December 2008 by the Monitoring Committee. The main changes made were in the areas of risk management, executive pay, shareholder responsibility, diversity in the composition of the supervisory board and corporate social responsibility. The role of the supervisory board has been strengthened, for example in relation to takeover bids. A response time has also been introduced to give the management board the opportunity to give due consideration to all interests when confronted with a shareholder proposing a different strategy.

However, there currently are changes in law envisaged. As from 1 January 2013 provisions will be included in the Dutch Civil Code regarding gender diversity in board rooms and limitation of multiple directorships. Also on that date the current rules regarding conflict of interests of management directors in the Dutch Civil Code will be amended, and will become similar to those in the Dutch CG Code.

The Monitoring Committee concluded that the Dutch CG Code should encourage proper conduct on the part of management and supervisory board members and shareholders. This is why in the revised code more emphasis is placed on how they perform their duties in practice rather than on how they account for their actions in retrospect. The Monitoring Committee believes that the decisive factor in the operation of the code is not strict compliance with the letter of the code (ie 'box ticking') but the extent to which in practice all concerned act in accordance with the spirit of the code.

The [Dutch] Monitoring Committee believes that the decisive factor in the operation of the code is not strict compliance with the letter of the code (ie 'box ticking') but the extent to which in practice all concerned act in accordance with the spirit of the code.

Taking a high level view of the list of recent or envisaged changes in Belgium's neighbouring countries we see the following most recurrent topics for revision: boardroom diversity, independent directors, directors' remuneration, the remit of the audit committee, the tasks of the external auditor and shareholder engagement. Most of these topics (i) will be discussed below or (ii) are already well developed in Belgian law or the Belgian 2009 Code. We find that all four of the reasons set out under 2.3(c), gave or are giving rise to the abovementioned recent and envisaged changes.

The comparison demonstrates that, whereas formerly there were often frequent revisions and a strict implementation of a general set of rules was supported, nowadays there are discernable trends towards keeping future changes to a minimum, with increased attention being paid to adherence to the spirit of the code (with an emphasis on qualitative 'explaining' and behaviour rules) rather than to the letter of the code (ie a box-ticking application of code), and the specific needs of different types of companies.

(b) The role of shareholders in corporate governance

(i) Addressing shareholders' duties in corporate governance codes?

Shareholders undeniably play a crucial role in the corporate governance of their investee companies by virtue of the fact that they generally are the primary beneficiaries of the corporate governance rules. Their monitoring of the corporate governance rules and standards is important and often proves effective.

But the role of shareholders may in fact go beyond the mere monitoring function. Shareholder engagement in the governance of the investee company constitutes a crucial component in its checks and balances. The shareholders need to actively and critically enter into dialogue with the other shareholders and with the board members.

The nature of shareholder engagement is connected with the ownership structure.

Controlling shareholders are often represented at the board level, giving them a direct say in the governance of the company. They not only have an active duty to pay attention to the organisation of the corporate governance of the company, but also have several direct responsibilities, including the duty to respect the minority shareholders, to secure transparency and to avoid possible conflicts of interest. Since controlling shareholders will not only engage at the general meeting, but will also engage via other channels, the role of minority shareholders in the general meeting is of great importance.

Institutional shareholders, in particular, may have considerable influence on corporate governance.³⁹ Consequently, they are increasingly being expected to be transparent about their voting policy and behaviour and about the monitoring of asset managers. This may be relevant in the context of a concentrated shareholding (to balance the powers of the controlling shareholder) as well as in the context of a dispersed shareholding (where they may balance the powers of the board/management).

However, studies show that shareholders do not fully utilise their monitoring role and that in practice, there is an increasing demand for more active shareholder engagement, especially by institutional shareholders. The sometimes limited powers granted to the shareholders by national law, the costs of engagement, the difficulty of valuing the engagement and the uncertainty of the outcome of the engagement are often presented as reasons for the ‘absent owner’ phenomenon, particularly in companies with a dispersed ownership, but also, as far as minority shareholders are concerned, in controlled companies.⁴⁰

“The corporate governance framework is built on the assumption that shareholders engage with companies and hold the management to account for its performance. However, there is evidence that the majority of shareholders are passive and are often only focused on short-term profits.”

The 2011 Green Paper

Within the scope of this study, we assess to what extent corporate governance codes currently focus on shareholder engagement⁴¹, and

whether corporate governance codes actually are the appropriate tools to address shareholders. In making these assessments, we focus on shareholder engagement in general, regardless of the ownership structure and the presence of institutional shareholders.

We find that in general the codes, with the UK Stewardship Code as a noteworthy exception, contain many duties for the directors to inform and engage with the shareholders, but few duties for the shareholders themselves. This may be partially explained by the fact that the codes are addressed to listed companies and their boards (and not to their shareholders) and that it is hard to fit obligations for shareholders within the ‘comply or explain’ structure.

UK

The UK CG Code states that companies and shareholders have a shared responsibility for ensuring that the ‘comply or explain’ approach remains an effective alternative to a rules-based system. The UK CG Code contains a section entitled ‘Relations with shareholders’, in which it states that there should be dialogue between the board of directors (often through the chairman) and major shareholders. Since the Stewardship Code has come into effect, Schedule C to the UK CG Code, concerning ‘Engagement principles for institutional shareholders’, has ceased to apply.

³⁹ Klaus J. Hopt (Max Planck Institute and European Corporate Governance Institute (ECGI)), *Comparative Corporate Governance: The State of the Art and International Regulation*, January 2011, p 54; see also: Monitoring Study, p 434 concerning the UK: *“Although not a body formally responsible for monitoring the code, the role of institutional investors and voting services firms should not be ignored. Investors are crucial in monitoring and enforcing corporate governance standards and in particular the code. They are influential both in the way that individual companies comply with the code and also in helping setting market standards through guidelines such as the ABI and NAPF guidelines.”*

⁴⁰ Klaus J. Hopt (Max Planck Institute and European Corporate Governance Institute (ECGI)), *Comparative Corporate Governance: The State of the Art and International Regulation*, January 2011, p 51; 2011 Green Paper, p. 11

⁴¹ This should of course be put into the perspective of the powers attributed to the shareholders by the national law. For a good comparative overview : C. Van der Elst, *Shareholder Rights and Shareholder Activism : the role of the General Meeting of Shareholders*, March 2012.

The Stewardship Code directly addresses institutional investors, setting out seven principles and guidance for institutional investors to follow. However, these institutional investors are free to choose whether or not to engage.

The Stewardship Code aims to provide guidance for good practice on monitoring and engaging with investee companies and reporting to clients and their beneficiaries. The code is composed of principles and guidance provisions, both of which are subject to the 'comply or explain' principle.

To further support the role of shareholders in corporate governance, the FSA is consulting on a number of changes to the Listing Rules regime aimed at reinforcing the higher standards of corporate governance requirements for companies with a controlling shareholder. The proposals include:

- introducing the concept of a 'controlling shareholder' (being broadly a shareholder holding at least 30% of the shares or voting power in the listed company or its parent or exercising significant influence over the management of the listed company);
- requiring that an agreement is put in place to regulate the relationship between the controlling shareholder and the listed company and introducing a new compliance statement in relation to the operation of the relationship agreement in the annual financial report
- requiring that the listed company is capable of acting independently of a controlling shareholder;
- requiring a majority of independent directors on the board or for an independent chairman and independent directors together making up at least half the board; and
- providing additional voting powers for independent shareholders for the election of independent directors and for approval of material changes to a relationship agreement.

France

The AFEP MEDEF Code does not contain any specific general shareholders duties. However, it does address the majority shareholder by stating that it assumes a specific responsibility to the other shareholders, which is direct and separate from that of the board of directors. The code states that the majority shareholder must take particular care to avoid possible conflicts of interest, to secure transparency of the information provided to the market, and to fairly take all interests into account. The code also recommends appointing independent directors in controlled corporations. However, the shareholders do not have a duty to report to the board of directors, and there are no specific requirements regarding this matter in the internal control procedure and corporate governance reports drawn up by the chairmen of French listed companies. As a result, such a recommendation can be considered to be only a very high level recommendation.

The French Middelnext Code aims to offer small- and medium-sized listed companies, which often have a controlling shareholder, guidelines for evaluating their governance. However, the Middelnext Code explicitly states that it does not intend to make recommendations to shareholders, but that it nevertheless wishes (via *points de vigilance* and recommendations) to draw attention to several points to which the board of directors should pay particular attention with respect to shareholder engagement.

The Netherlands

The Dutch CG Code directly addresses the shareholders in certain of its principles and best practice provisions. It does so in its main body via principles and best practices, which include the application of the 'comply or explain' principle.

In accordance with section 5:86 of the Financial Supervision Act (*Wet op het financieel toezicht*), since 1 January 2007 Dutch institutional investors must include in their annual report or on their websites a statement about their compliance with the principles and best practice provisions that apply to them.⁴² Non institutional shareholders, however, are not required to apply the 'comply or explain' rule.

⁴² From the monitoring report 2011 of the Dutch Monitoring Committee Corporate Governance Code, it appears that large institutional investors comply with the CG Code to a high degree.

The preamble to the Dutch CG Code states that the greater the interest that a shareholder has in a company, the greater its responsibility to the company, the minority shareholders and other stakeholders.

Indeed in its first principle on the compliance with and the enforcement of the Dutch CG Code, the code addresses the shareholders directly, stating that shareholders should: *“take careful note and make a thorough assessment of the reasons given by the company for any non-application of the best practice provisions of this code. They should avoid adopting a ‘box-ticking approach’ when assessing the corporate governance structure of the company and should be prepared to engage in a dialogue if they do not accept the company’s explanation.”*

In another principle concerning the shareholders and the general meeting of shareholders, the code requires shareholders to take a critical attitude and a fully involved participation (in the decision-making at the general meeting, as well as in monitoring adherence to corporate governance rules).

Further, the code contains a principle concerning depositary receipts for shares (ie means of preventing a (chance) majority of shareholders from controlling the decision-making process as a result of absenteeism at the general meeting). In general, holders of depositary receipts for shares are only entitled to financial rights and cannot exercise the voting rights attached to shares. According to the Dutch CG Code, however, the management of the trust office shall issue voting proxies in all circumstances and without limitation to the holders of depositary receipts who so request. The holders of depositary receipts thus authorised can exercise the voting rights at their discretion. This principle is developed through best practice provisions addressed at the management of trust offices (*administratiekantoren*), who are, from a corporate law perspective, the shareholders. However, it should be noted, that contrary to the Dutch CG Code, the Dutch Civil Code contains a provision that stipulates that the trust office may decide not to issue voting proxies in all circumstances to holders of depositary receipts for shares.

The code finally also touches upon the duties of (institutional) shareholders. The shareholders are required to act in keeping with the principles of reasonableness, fairness and willingness to engage in dialogue.

Italy

The Italian CG Code mainly sets out the duties of the directors vis-à-vis the shareholders, but not vice versa. It contains a chapter entitled ‘Relations with shareholders’ in which it states: *“The Committee believes that it is not in its responsibility to take into consideration the behaviour of institutional investors. The Committee, moreover, is of the opinion that the acknowledgement by them of the importance of the corporate governance rules contained in this Code may represent a significant element for the purpose of a more convinced widespread application of the principles of the Code by the issuers.”*

The Italian CG Code indirectly touches on the subject of controlling shareholders, describing the importance of (i) continuing dialogue with the investors, (ii) the protection of minority interests and (iii) transparency in the presence of a controlling shareholder. It suggests, in the event that the office of chairman is held by the person controlling the company, appointing an independent director as lead independent director.

Germany

The German CG Code defines the role of the general meeting and describes its organisation, but does not deal with shareholders duties. However, the behavioural duties of controlling shareholders – or as the law refers to them, *“shareholders with influence”* – are dealt with by law. In this regard, § 117 AktG states that if such influence is used to influence a member of the executive or supervisory board, or a member of the upper management of the company, to act to the detriment of the company or its shareholders, the influencing shareholder is liable for any damage suffered as a result. In addition, § 53 a AktG imposes a fiduciary duty on shareholders to act in furtherance of the company goals.

The eighth principle of the Belgian 2009 Code highlights the importance of a dialogue with (potential) shareholders. The board of directors is recommended to take the necessary measures to encourage shareholders, and in particular institutional shareholders, to play a significant role in carefully evaluating the company's corporate governance and carefully considering the explanations given for deviating from the code. In addition, the board is recommended to endeavour to ensure that the controlling shareholders make a considered use of their position and respect the rights and interests of minority shareholders. The recommendation is addressed to the board (not to the shareholders themselves) and the 'comply or explain' principle applies to these recommendations.

In its preamble, the Belgian 2009 Code addresses the shareholders in a more direct way, stating that "*they should be prepared to enter into a dialogue if they do not accept the company's position, bearing in mind, in particular, the size and complexity of the company and the nature of the risks and challenges it faces*". It furthermore states that controlling shareholders should make considered use of their position and respect the rights and interests of minority shareholders.

Addressing shareholders to engage them in the corporate governance of their investee companies is increasingly being considered a matter of importance, but this goal does not necessarily need to be achieved via the same channels as used for boards of directors. We note that even if a corporate governance code contains direct obligations for shareholders, the 'comply or explain' principle will still not apply in most cases (except, for example, in the Netherlands where the 'comply or explain' principle does apply to institutional investors with respect to certain specific provisions) and is in any event difficult to implement. Indeed, a corporate governance code may not be the most appropriate tool for involving shareholders in corporate governance.

Separate guidance notes or separate codes (such as the UK Stewardship Code), which are addressed specifically to shareholders, may prove effective in showing the way to shareholders and specifically to institutional investors, which often face the difficult situation of having to deal with a large universe of companies, spread around the world, with diverse corporate governance traditions referring to different codes.

Although shareholder engagement is an essential element for the good functioning of the corporate governance code, the code may not be the right place to address shareholders. It is indeed important to make the distinction between (i) corporate governance rules, primarily addressed to companies and their boards and committees; and (ii) shareholder governance rules, addressed to (institutional) shareholders. In our view it is preferable that the shareholder governance rules are laid down in a separate code or guidance note, for which moreover no legal embedment is required.

(ii) Trends in ways to enhance shareholder engagement

The 2011 Green Paper observes that there is evidence that the majority of shareholders are passive and are often only focused on short-term profits. Due to this short-termism, voting practices may not correspond with the idea of a shareholder's engagement based on the assumption that the shareholder, as ultimate risk bearer, (i) is entitled to decide on essential matters relating to the company and (ii) has interests which are aligned with the interests of the company.⁴³

It is therefore useful to assess how issues concerning shareholder engagement can be remedied and consider how to encourage shareholders to be more active on corporate governance issues.

⁴³ Cfr. the practice of 'empty voting': Statement of the European Corporate Governance Forum on Empty Voting and Transparency of Shareholder Positions, February 2010

Against the background of the foregoing, the following topics are currently being debated at the EU level⁴⁴ and in several other corporate governance forums:

- Enhancing **transparency on shareholder positions** and developing a framework for **transparency in voting policies** and disclosure of general information about their implementation.
- Facilitating **shareholder identification** (which would enhance the dialogue between the company and its shareholders and shareholders involvement): lowering thresholds for notification of a major holding in the Transparency Directive or, in addition to existing transparency rules, measures which range from (i) requiring issuers to offer forums to shareholders on their corporate websites to (ii) a fully fledged EU system of shareholder identification.
- Improve **minority shareholder protection**: (i) additional rights, for example requiring shareholder approval of key corporate decisions, giving minority shareholders the right to appoint or nominate directors, setting a minimum percentage of independent board members, ensuring equal access to information, abolishing multiple voting rights, and (ii) additional protection against related party transactions, by appointing an independent expert to provide an impartial opinion on the terms and conditions of related party transactions to the minority shareholders or by requiring shareholder approval for significant related party transactions.
- Remedying issues related to the **agency relationship between institutional investors and their asset managers** by, inter alia requiring a greater disclosure of the incentive structures for asset managers and more transparency about the performance of fiduciary duties by asset managers, which would help institutional investors to better monitor their asset managers.⁴⁵ Recent changes to the UK Stewardship Code include clarifying the respective responsibilities of the assets owners and the assets managers.
- Addressing **proxy advisors' influence on voting**: (i) enhancing transparency by requiring proxy advisors to disclose the methods applied with regard to the preparation of the advice, by requiring proxy advisors to register and become supervised entities or by requiring institutional investors to disclose when they make use of the services of a proxy advisor; and (ii) introducing measures to address conflicts of interest of proxy advisors, such as requiring a mandatory separation of services provided to investors and to companies or a mandatory disclosure if proxy advisors also provide services to investee companies.

The above proposals are currently only at an early stage of development. It is unclear how they will evolve. Especially considering the fact that many institutional shareholders in Belgian listed companies are foreign, it is important that any Belgian rules addressed to institutional investors are in line with international practices.

Furthermore, the proposals deal with the crux of governance issues affecting institutional shareholders but, as far as Belgium is concerned, they may need to be adapted to and further developed to take account of the controlled shareholding environment. In this respect, the proposals on which the FSA is currently consulting and which do deal with specific corporate governance requirements for listed companies with a controlled shareholding, may not be easily transposable in a Belgian context. The requirements for a majority of independent directors in controlled companies is quite progressive and could, in our view, potentially discourage controlled companies from listing or remaining listed on a stock exchange. The requirements concerning the relationship agreements, which are typically designed to ensure that the company can carry on its business independently from the controlling shareholder and that transactions between the company and the controlling shareholder are on an arm's length basis, are less relevant in a Belgian context as this concern is largely being covered by article 524 of the Belgian Company Code.

⁴⁴ 2011 Green Paper, p. 11, 2011 Feedback Statement p. 16.

⁴⁵ In France, for helping the asset management companies to fulfil their fiduciary responsibilities, the association which represents them (l'Association de la Gestion Financière – l'AFG) has issued recommendations relating to "what it could be considered as the best corporate governance practices" in a code named the AFG Code (the 2012 edition is the tenth edition). These recommendations set shareholding voting criteria for managers of the AFG members.

The increased focus on shareholder engagement, stewardship and shareholder transparency is an important trend, which seems irreversible. Things are developing quite rapidly in this area and the Belgian governance framework which, as in most of the continental countries, is currently quite limited in this regard, may require updating in the short term.

At EU level, there are currently some proposals on the table which aim to enhance shareholder engagement. These proposals are only in an early stage and it is unclear how they will develop. They may not be entirely adequate for jurisdictions with a predominant controlled shareholding.

However, the corporate governance codes may not be the most appropriate tool to address shareholders: it may be preferable to lay down the shareholder governance rules in a separate code or a guidance note, for which moreover no legal embedment is required.

(c) Corporate governance rules reflecting company size?

Small- and medium-sized listed companies may face governance concerns that are different from those of large companies. Existing corporate governance codes seem to be typically designed for large companies, often assuming a dispersed shareholding. Consequently, some of the underlying principles underpinning the existing codes may not be relevant or appropriate for small- and medium-sized listed companies.

Ensuring compliance with corporate governance codes indeed appears to be less evident for small- and medium-sized listed companies⁴⁶, not necessarily because they suffer from poor governance, but precisely because the codes are not tailored to their specific needs and concerns.

In its publication “*Corporate Governance, Value Creation and Growth – The Bridge between Finance and Enterprise*” (the **OECD Publication**), the OECD discusses ‘scaled regulation’, referring to regulation adapted not to the size of companies, but to the different stages of the life cycle of companies after an IPO. Corporate governance rules could indeed be designed to take into account not only the size, but also the ‘maturity’, and even the ownership structure and the sector of companies (eg holding companies). However, in this study we only examine the question of whether corporate governance rules should be differentiated to take into account the size of such companies so as to create or safeguard a level playing field.

In view of the different corporate governance issues faced by small- and medium-sized companies, some jurisdictions do already have specific corporate governance codes or rules tailored to these companies.

- A salient example is the French Middlednext Code.⁴⁷ This code has been specifically designed for small- and medium-sized listed companies, precisely because of their typical characteristics and needs. Taking into account their often different ownership structure, with important major shareholders who are represented on the board of directors, the Middlednext Code provides corporate governance recommendations for small- and medium-sized listed companies, with a focus on corporate governance issues in connection with the freedom of entrepreneurial action of directors and the protection of minority shareholders.⁴⁸

⁴⁶ Centre for European Policy Studies (CEPS), *Corporate Governance Reform in the EU*, August 2009, p. 3; OECD Publication, p. 17.

⁴⁷ *Code de gouvernement d'entreprise pour les valeurs moyennes et petites*, December 2009, Middlednext, available at <http://www.middlednext.com/>.

⁴⁸ Provisions of the Middlednext Code concern, for example, (i) the presence of independent board members (which may be difficult to find for small- and medium sized listed companies, but are important for safeguarding the interests of minority shareholders and for the other stakeholders); (ii) board members' awareness of the deontological rules (given the fact that board members representing a familial shareholding are not always well informed on their tasks); (iii) the set up of committees by the board (since the size of the addressed companies does often not require a set up of several specialised committees); (iv) shareholder engagement, via ‘*points the vigilance*’, addressed to board members (since small- and medium-sized listed companies are often have a controlling shareholder which is represented in the board and which thus requires attention for the minority shareholders engagement).

- In other jurisdictions (such as the UK⁴⁹, the Netherlands⁵⁰ or Italy⁵¹) codes addressed to all listed companies state sometimes that the company's size is to be taken into consideration when applying the recommendations and the codes include certain provisions which only apply to large companies.

However, at the level of the EU⁵², and in most individual member states, we observe that generally there is no such differentiated approach.

The question of whether corporate governance rules should be differentiated and a proportionate regime should be established for small- and medium-sized listed companies was raised in April 2011 in the consultation launched by the EC.⁵³ The majority of the respondents to this consultation appeared not to be in favour of having different corporate governance regimes based on the size of the respective companies. The 2011 Feedback Statement sets out the following three main arguments that were presented in this respect⁵⁴:

- The 'comply or explain' mechanism already offers enough flexibility, as it allows listed companies to apply only those recommendations which are suitable to their specific situation, such as their size.
- From an investor perspective, it is important, in order to remain attractive and not to fall into a 'sub-standard' category, that listed companies provide the same corporate governance standards across all market capitalisations, particularly with respect to transparency.
- It is difficult to determine meaningful size thresholds across the EU.

On the other hand, the desire to reduce the administrative burden of small- and medium-size listed companies was an important argument used by those supporting differentiation.

NYSE Euronext's Strategic Planning Committee for SMEs, in the context of its recent proposal for a new exchange addressing the financing needs of SMEs (the Entrepreneurial Exchange), also calls for the widespread adoption of codes of governance written especially for SMEs.⁵⁵

⁴⁹ Eg provision B6.2 of the UK CG Code which states that the evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years; provision B.7.1 states that all directors of FTSE 350 companies should be subject to annual election by shareholders.

⁵⁰ Eg provision II.1.3 of the Dutch CG Code which requires that companies must have an internal risk management and control system in place that is suitable for the company.

⁵¹ Eg provisions 2.3.C (concerning the designation of a lead independent director) and 3.3.C (on the number of independent directors) of the Italian CG Code.

⁵² The Statutory Audit Directive however, allows member states to permit SMEs that are listed companies to be exempt from the requirement to set up a separate audit committee.

⁵³ Question 1 of the 2011 Green Paper: *Should EU corporate governance measures take into account the size of listed companies? How? Should a differentiated and proportionate regime for small- and medium-sized listed companies be established? If so, are there any appropriate definitions or thresholds? If so, please suggest ways of adapting them for SMEs where appropriate when answering the questions below.*

⁵⁴ 2011 Feedback Statement, p. 5.

⁵⁵ Strategic Planning Committee of NYSE Euronext, *Strategic Planning Proposal: Creating "The Entrepreneurial Exchange"*, July 2012, p. 31.

The table below succinctly sets out arguments for and against differentiating rules and establishing a proportionate regime for small- and medium-sized listed companies:

For	Against
The existing corporate governance rules contain a number of recommendations that are disproportionate for small- and medium-sized companies.	The admission to listing justifies imposing several rules.
The introduction of differentiated proportionate rules could mitigate the hidden costs of the application of a strict corporate governance framework. ⁵⁶	Corporate governance is about having meaningful general standards, allowing a comparison to be made between companies.
The risk of being perceived as sub-standard may not be an issue if such SME code is aligned with other precedents (eg Middennext) or even a joint cross-border initiative (eg Euronext).	It is important for SMEs not to fall into a 'sub-standard'.
Small- and medium-sized listed companies need to 'explain' more often than large companies and monitoring shows poor compliance results for these companies, which gives them a bad image and does not motivate them to work on corporate governance.	The 'comply or explain' mechanism provides sufficient flexibility.
It is important not to discourage small- and medium-sized companies from listing on a stock exchange (especially in Belgium).	In the OECD Publication it is stated that there is empirical evidence that seems to indicate that the mere introduction of scaled corporate governance rules and regulations will not automatically lead to more IPOs. ⁵⁷
There are useful definitions and methodologies available: existing differentiated approaches prove to be efficient (eg regarding compliance).	Where do we draw the line?

We see that there is a tension between: (i) relieving the requirements for small- and medium-sized listed companies, and (ii) ensuring a standard set of corporate governance rules are respected by listed companies while avoiding opening the door to the creation of a complex patchwork of corporate governance codes or guidance notes tailored to companies with different characteristics.

In our view, more attention for high-quality 'explaining' (possibly in combination with indications of provisions which are less relevant for small- and medium-sized listed companies) could increase the market acceptance of the 'explaining'. It could take away the negative connotation of non-compliance and could allow for applying the existing 'uniform' codes to small- and medium-sized listed companies.

Explicitly stating that small- and medium-sized listed companies can deviate from the code's provisions if they 'explain' the deviation and upgrading the value of 'explaining' by confirming that qualitative 'explaining' indicates good governance rather than bad governance could facilitate the use of a single code for companies of different sizes. The code itself or a separate document may indeed give legitimacy to, and upgrade the value of, the 'explaining' by small- and medium-sized listed companies.

The Netherlands

The Dutch CG Code states: "*Shareholders take careful note and make a thorough assessment of the reasons given by the company for any non-application of the best practice provisions of this code. They should avoid adopting a 'box-ticking approach' when assessing the corporate governance structure of the company and should be prepared to engage in a dialogue if they do not accept the company's explanation. There should be a basic recognition that corporate governance must be tailored to the company-specific situation and that non-application of individual provisions by a company may be justified.*"

⁵⁶ OECD Publication, p. 16.

⁵⁷ OECD Publication, p. 17.

 The UK

The UK CG Code sets out in its note on ‘comply or explain’ the following: “*In their responses to explanations, shareholders should pay due regard to companies’ individual circumstances and bear in mind, in particular, the size and complexity of the company and the nature of the risks and challenges it faces. Whilst shareholders have every right to challenge companies’ explanations if they are unconvincing, they should not be evaluated in a mechanistic way and departures from the Code should not be automatically treated as breaches. Shareholders should be careful to respond to the statements from companies in a manner that supports the ‘comply or explain’ process and bearing in mind the purpose of good corporate governance. They should put their views to the company and both parties should be prepared to discuss the position.*”.

The preamble of the Belgian 2009 Code states that, with respect to the ‘comply or explain’ mechanism, smaller companies, for example, may consider that some provisions are disproportionate or less relevant. The CGC has also composed Practical Rules for high-quality ‘explaining’. With this as impetus, a general debate can be stimulated on the increased utilisation by small- and medium-sized listed companies of the possibility to ‘explain’.

On the other hand, we are not opposed to establishing a separate code for small- and medium-size companies provided that it is optional and substantially in line with other precedents or even part of a joint cross-border initiative (eg by NYSE Euronext).

The question of whether corporate governance rules should be tailored to small- and medium-sized listed companies is relevant for this study, since there are a significant number of such companies in Belgium. It is important to encourage IPOs of small- and medium-sized listed companies and to avoid them withdrawing from the stock exchange because of disproportionate corporate governance requirements. However, this is a topic that is the subject of a significant debate. The arguments for and against are fairly evenly matched.

(d) Behavioural rules for directors

Confronted with a box-ticking formalistic application of the codes, the authors of the codes may be inclined to go beyond the compliance-driven and procedural provisions and include a more performance and behavioural approach. Studies and monitoring reports indeed point out that irrespective of how detailed corporate rules may be, actual behaviour, quality and ethics are important.

Such behavioural provisions can be vague or precise, general or specific. It is often difficult, and may be counter productive, to impose strict and hard rules on directors. It is, however, certainly the aim of a corporate governance code to steer directors in their performance to ensure they discharge their duties in the best interests of the company.

“A possible reason for why many boards are still found wanting is the fact that despite rigorous efforts to raise governance standards, insufficient attention has been paid to the behavioural standards as opposed to the technical challenges of the boardrooms”

2011 Heidrick & Struggles

One may question whether a corporate governance code is the right place to set out conduct rules for directors. In principle, individual directors can not be considered as addressees of the code: the first addressee of the code is the company as a whole, represented by the board as a whole. Also, the application of the ‘comply or explain’ principle, which is typical for corporate governance codes, is not evident for general behavioural or ethical rules of conduct for directors.

We note that the corporate governance codes of Belgium, France, Germany, Italy, the Netherlands and the UK do contain various rules of conduct, which are presented in many different ways. The following conduct rules are most frequently mentioned in the corporate governance codes:

- **Availability/commitment** – All but one (being the Dutch CG Code) of the codes refer to a general standard of availability or commitment of directors. In all of the studied codes this general rule of conduct is reflected in more down-to-earth procedural rules, such as a maximum number of positions or offices that directors or chairmen may hold and the requirement to disclose the attendance rate of individual directors.⁵⁸
- **Entrepreneurship/Leadership** – All but three (being the German, the AFEP MEDEF and the Italian CG Code) of the codes cite or refer to (sometimes in the preamble and sometimes in the main body) this more abstract rule of conduct.
- **Confidentiality/Discretion** – Except for the Dutch CG Code and the UK CG Code, the codes refer to confidentiality or discretion. The confidentiality duty is a clear and precise rule, which in principle allows it to be imposed by a corporate governance code. The duty of confidentiality is often supplemented with a transparency or disclosure requirement (*inter alia* in the light of the ‘comply or explain’ principle).
- **Autonomy/Independent judgement** – Except for the French Middenext Code and the German CG Code, all of the codes refer to ‘autonomy’, ‘independence’ or ‘critical reflection’ as a rule of conduct for directors.
- **Integrity/Honesty/Loyalty**⁵⁹ – In all but two (being the German and the Italian CG Code) of the codes, reference is made to the more ‘ethical’ rules of conduct of integrity, honesty and loyalty. Whereas in the French CG Code, the ‘comply or explain’ principle is applicable to such rules, the UK CG Code and the Dutch CG code only refer to these rules of conduct in the preamble, so the ‘comply or explain’ principle does not apply to them. The Belgian 2009 Code refers to ‘integrity’ in its third principle, to which the ‘comply or explain’ principle also does not apply.
- **Acting in the corporate interest** – The corporate interest is mentioned in each of the codes. This rule of conduct is referred to both in the preamble and in the main body of the codes. The need to act in the corporate interest can indeed be considered to be a ‘guiding principle’ throughout corporate governance.
- **Corporate Social responsibility/Acting in the interests of the stakeholders** – The Belgian 2009 Code, the Dutch CG Code and the German CG Code explicitly require directors to take corporate social responsibility or the interests of stakeholders into account. The abovementioned concept of corporate interest potentially also encompasses the interests of stakeholders.

⁵⁸ The 2011 Feedback Statement shows that only a minority of respondents was in favour of a measure at EU level limiting the number of mandates a non-executive director may hold. On the other hand, of the 2011 Heidrick & Struggles Study shows that countries with the least available directors and chairmen achieve a low corporate governance rating.

⁵⁹ The 2011 Heidrick & Struggles Study shows that several Belgian, French, German, Dutch and English companies have installed an ethics and social responsibility board committee.

COMMON RULES OF CONDUCT	AFEP MEDEF Code	Middlenext Code	German CG Code	Italian CG Code	Dutch CG Code	UK CG Code	Belgian 2009 Code
Availability/ Commitment	V <i>comply or explain</i>	V <i>comply or explain</i>	V <i>comply or explain</i>	V <i>comply or explain</i>	—	V <i>comply</i>	V <i>comply</i>
Entrepreneurship / Leadership	—	V <i>preamble</i>	—	—	V <i>preamble</i>	V <i>comply</i>	V <i>guideline</i>
Confidentiality / Discretion	V <i>comply or explain</i>	V <i>comply or explain</i>	V <i>comply or explain</i>	V <i>comply or explain</i>	—	—	V <i>guideline</i>
Autonomy / Independent judgement	V <i>comply or explain</i>	—	—	V <i>comply or explain</i>	V <i>comply or explain</i>	V <i>comply</i>	V <i>comply or explain</i>
Integrity / Honesty / Loyalty / Ethics	V <i>comply or explain</i>	V <i>comply or explain</i>	—	—	V <i>preamble</i>	V <i>preamble</i>	V <i>comply</i>
Corporate interest	V <i>comply or explain</i>	V <i>preamble</i>	V <i>comply or explain</i>	V <i>comment</i>	V <i>comply or explain</i>	V <i>comply</i>	V <i>comply</i>
CSR / Interests of the stakeholders	—	—	V <i>comply or explain</i>	—	V <i>comply or explain</i>	—	V <i>guidance</i>

In the light of its own traditions and culture, and in line with the existing applicable legal frameworks, each of the six studied jurisdictions has its own approach, its own specific emphasis and its own version of rules on conduct for directors.

 UK

In the UK, some conduct rules have been in place for many years and have been amended and added to over time to ensure they reflect market practice and the concerns of the business community generally. In addition, a number of directors' duties are codified in the Companies Act 2006.

The current UK CG Code⁶⁰ briefly describes rules of conduct for directors both in the preface and in the main body of the code. The conduct rules which are referred to in the preface to the UK CG Code but which are different from those mentioned above are rules regarding: personal reporting on governance by chairman, effective and prudent management, frankness, openness of mind, mutual respect and openness and accountability. The 'comply or explain' principle applies to the conduct rules included in the code provisions of the UK CG Code.

In March 2011 the FRC has issued a Guidance on Board Effectiveness which is intended to stimulate boards' thinking on how they can carry out their role most effectively.

 France

The French CG Code extensively describes general and specific conduct rules for directors in a section entitled "*Membership of the board of directors: guiding principles*" and a section entitled "*Deontology for directors*". In addition, the Middenext Code provides a set of deontological recommendations in its main body. The 'comply or explain' principle applies to the rules of conduct recommendations in both codes. The French rules of conduct are typical ethical rules of conduct such as honesty and loyalty. In France, the conduct rules are generally developed in a specific charter, including 'ethical' rules, addressed at the directors.

 Germany

The German CG Code provides succinct but diverse guidance on directors' conduct. The German rules of conduct are typically rules on ensuring good cooperation between management board and supervisory board, having open discussions and due care and diligence of a prudent and conscientious managing director or supervisory board member. In comparison with the rules of conduct included in the French codes, the rules of conduct referred to in the German CG Code can be described as 'qualitative' rather than 'ethical'. The conduct rules in the German CG Code are a mere description of directorial behaviour prescribed by the law. Hence, they are not expressed in form of a recommendation or a suggestion and they do not apply the 'comply or explain' principle.

 The Netherlands

The Dutch CG Code also contains quite a lot of conduct rules for directors. Typical behavioural rules which are included in the Dutch CG Code cover corporate social responsibility, accountability and critical reflection. The 'comply or explain' principle applies to both principles and provisions and therefore also to the conduct rules set out in the Dutch CG Code.

 Italy

The Italian CG Code only briefly touches upon rules of conduct for directors. The most prominent rules of conduct concern autonomy (independence of judgement), commitment and self-assessment. The conduct rules were included in the code from its first edition (1999). The 'comply or explain' principle applies to these conduct rules.

⁶⁰ The Preamble to the UK CG code states: "*The Code's function should be to help boards discharge their duties in the best interests of their companies. The FRC in this review has focussed on changing the "tone" of the Code by making limited but significant changes to signal the importance of the general principles which should guide board behaviours. It is to be hoped that these changes will promote greater clarity and understanding with regard to the tasks of a board and that communication with shareholders will be more effective as a result.*".

Compared to the corporate governance codes in the neighbouring jurisdictions, the 2009 Belgian Code contains a rather comprehensive set of (ethical and qualitative) behavioural rules for directors. Typical rules included in the Belgian 2009 Code in addition to those points referred to above are reflected in (i) the provision stating that no individual or group of directors should dominate the board's decision-making and that no one individual should have unfettered powers of decision-making; and (ii) the provision stating that necessary measures should be taken to develop a climate of trust within the board, contributing to open discussion, constructive dissent and support for the board's decisions.

The behavioural rules have been in place from the outset (ie they were in the Lippens Code) and were further developed in the current Belgian 2009 Code. Values such as entrepreneurship, integrity and commitment are emphasised. The various rules are set out in different parts of the code, ie in the preamble, as well as in its principles, provisions and guidelines. The applicability of the 'comply or explain' principle thus depends on where the relevant rule appears in the 2009 Belgian Code.

Clearly, having the right structures in place does not guarantee a well functioning board. If a box-ticking, formalistic application of corporate governance codes is applied, companies can lose sight of the true purpose of these codes.

Transparency can be a useful indicator of the extent of problems and a spur to promote appropriate behaviour. However, merely putting in place detailed disclosure requirements may not suffice, and may even be instrumental in creating a 'box-ticking' mentality and making the available information even more opaque. Enhancing the informative quality of 'explaining' deviations from the code may improve the situation but, in our view, can only partially remedy it.

"Boards need to think deeply about the way in which they carry out their role and the behaviours that they display, not just about the structures and processes that they put in place."

FRC Guidance on Board Effectiveness

Putting in place conduct rules for directors may encourage the desired behaviour and may discourage 'window-dressing' compliance with corporate governance codes. The 'comply or explain' principle is difficult to apply to these rules but board evaluation may be an occasion to monitor the behavioural rules. In a recent study of Heidrick & Struggles (the **2011 Heidrick & Struggles Study**), it is also recommended conducting deeper reviews of board performance that combine an assessment of process and structure with an evaluation of behavioural competencies.⁶¹

It seems indeed that both procedural/technical rules and behavioural rules are needed to achieve the goals that an effective corporate governance framework should serve.

But are corporate governance codes the ideal place to 'accommodate' a set of behavioural rules for directors?

One could conceive a structure in which behavioural rules are set out in codes' principles (which must be complied with), but for which the corresponding technical rules could then be developed in the provisions (to which the 'comply or explain' principle applies). Indeed, many procedural rules are mere illustrations of more general rules of conduct. For instance, provisions on the maximum number of board mandates and provisions on the disclosure of individual board attendance rate in practice aim to ensure the availability and commitment of the directors.

However, firstly codes are not primarily addressed to individual directors: they are addressed to companies and to the board as a whole. Secondly, not all behavioural or ethical rules (and especially those without a corresponding technical rule, such as loyalty, entrepreneurship and openness of mind) are suitable to be included as principles in a code. An annex or a separate guidance note may consequently be a more appropriate place to address those rules.

⁶¹ Heidrick & Struggles, European Corporate Governance Report 2011, Challenging board performance, 2011, p.13.

The Guberna initiative of providing guidance for individual directors (“*Toolkit for the Director*”), which is to be presented in November 2012, will be very welcome. It is important to ensure that the company has the commitment of each individual director, and to explicitly indicate the duties incumbent upon each director.

The importance of this guidance for individual directors may then be invigorated by a reference in the corporate governance code. Such reference can be made at two levels: (i) for the board evaluation, where the individual behaviour and compliance with rules of conduct could be taken into account and (ii) for the selection process, where more emphasis could be placed on soft aspects (such as attitude, values, commitment, etc.). In this way, ‘director governance’ will become another supporting beam of the existing corporate governance code and the entire Belgian corporate governance framework.

We find that the Belgian 2009 Code contains a rather extensive set of both ethical and qualitative rules of conduct for directors. However, the Belgian 2009 Code may not be the most suitable place for rules of directors’ conduct, since a corporate governance code is by definition addressed to the companies (and thus to the boards of directors as a whole and not the individual directors).

Also, behavioural rules are difficult to build within the structure of the Belgian 2009 Code: there are too many of them to include them in the principles, they are not 100% compatible with the ‘comply or explain’ principle which applies to the provisions, and yet they are somewhat too numerous and too important (especially as compared to the technical rules) to include them in the guidelines.

We welcome the Guberna initiative of providing a guidance specifically addressed to individual directors (“*Toolkit for the Director*”). The code can then recommend the assessment of these individual rules of conduct or behavioural aspects (i) at the directors’ evaluation and (ii) at the directors’ (re-)appointment.

(e) Interaction between the audit committee and the external auditor

With the increasing importance of corporate governance in the EU (including the growing demand for transparency and a greater scrutiny by regulators and investors) the roles of the audit committee⁶² and the external auditor⁶³ have become building blocks of the corporate governance frameworks in the EU member states.⁶⁴

The interaction between the audit committee and the external auditor, ie *inter alia* the selection, appointment and dismissal of the external auditor, the auditor’s reporting to the audit committee and the audit committee’s assessment is indeed an important aspect in corporate governance. However, practice shows that there is room for improvement. A well defined framework may add to a candid and effective relationship between the external auditor and the audit committee.

Within the scope of this study (ie assessing whether the Belgian 2009 Code needs to be amended), we focus on recommendations that are addressed to audit committees rather than on recommendations that are addressed to external auditors, since corporate governance codes are in principle addressed to companies and the boards and their committees (including audit committees), but not to external auditors.

⁶² Companies which meet the requirements of article 526bis, §3 CoC may permit that the functions assigned to the audit committee to be performed by the board as a whole, provided that if the chairman of the board is an executive member the chairman shall not chair the board operating as audit committee (art. 526bis, §3 of the Belgian Company Code).

⁶³ Not only because the auditor’s role has an impact on the governance of the company, since it enhances transparency and the provision of correct information to shareholders and forms, in a way, a counterbalance to the power of directors, but also because the external auditor plays a certain role in monitoring the company’s compliance with corporate governance rules. In the Circular of the Belgian Institute for Auditors (Omzendbrief 2011/10 van het Belgisch Instituut van Bedrijfsrevisoren) it is pointed out that the corporate governance statement forms an integral part of the annual report, which is controlled by the auditor. In this respect that the auditor must verify whether (i) the annual report (including the corporate governance statement) is complete; (ii) the annual report (including the corporate governance statement) is in accordance with the annual accounts and (iii) the annual report (including the corporate governance statement) does not contain any manifestly unreasonable, incorrect or inconsistent information. According to the Belgian Institute of Auditors, the auditor does not need to give a qualitative assessment on the content of the annual report (including the corporate governance statement).

⁶⁴ European Confederation of Directors’ Associations (ecoDa), *Audit Committee Guidance for European Companies*, September 2011, p. 5

(i) Emphasis on hard law

The 2006 EU Statutory Audit Directive aimed to achieve high-level (though not full) harmonisation of statutory audit requirements among member states.⁶⁵ The Belgian law of 17 December 2008 regarding the establishment of an audit committee in listed companies and financial companies implemented several provisions of the Statutory Audit Directive. This law inserted, *inter alia*, a new article 526bis into the Belgian Company Code, concerning the audit committee.

“The crisis has shown that self-regulation is not adequate when looking towards the future.”

EC explanatory memorandum to the
Proposed Regulation

Following a broad consultation in the framework of the Green Paper entitled ‘Audit Policy: Lessons from the Crisis’ issued on 13 October 2010 (the **Audit Green Paper**), the EC has issued a Proposal for a Regulation of the European Parliament and of the Council on specific requirements regarding the statutory audit of public-interest entities (the **Proposed Regulation**).

With respect to audit, the EC seems to indeed have come to the conclusion that soft law and self-regulation are inadequate. The EC is consequently striving to achieve a higher degree of harmonisation. Several proposals from the EC to the European Parliament and Council to amend or complement the existing EU corporate governance regulation, as well as certain requirements currently set out in the Statutory Audit Directive, are expected to be integrated in the Proposed Regulation. Therefore, most of the EU framework on audit will find its way, either directly or through implementing legislation, in hard law.

This potentially entails overlaps or even inconsistencies between recommendations included in corporate governance codes and legal provisions. We refer to section 3.2 which elaborates on this subject.

(ii) EU proposed changes

Proposed measures which are included in the Proposed Regulation and relate to the interaction between the audit committee and the external auditor concern *inter alia* (i) clarifying and better defining the role of the external auditor; (ii) improving the information that the external auditor provides to the audit committee; and (iii) improving the communication channels between the external auditor and the audit committee.

A few noteworthy of these proposed measures are set out below.

- The Proposed Regulation provides a reinforced role for the audit committee in the procedure for selecting and appointing the auditor. The role should, in principle, include organising audit tenders at regular intervals based on a mandatory audit firm rotation (which is linked to a maximum duration of the audit engagement). The Proposed Regulation also contains a measure on the appointment of more than one external auditor.
- The Proposed Regulation includes an obligation on the external auditor to submit an additional internal report on the results of the statutory audit to the audit committee. This internal report would supplement the already published audit report, and should include more detailed information about the audit for the benefit of the audit committee and its monitoring responsibilities.

“It is also important that the role of the audit committee in the selection of a new statutory auditor or audit firm be reinforced, for the benefit of a more informed decision of the general meeting of shareholders or members of the audited entity.”

Proposed Regulation

⁶⁵ Recital 5 of the Statutory Audit Directive.

- In the Proposed Regulation, the EC expects that the audit committee carries out regular assessments of the functioning of the auditor and the cooperation between the external auditor and the audit committee.
- The Proposed Regulation provides that an external auditor carrying out the statutory audit of a listed company shall not directly or indirectly provide non-audit services to the audited entity, its parent undertaking and its controlled undertakings, unless (i) for certain services, the audit committee has authorised the provision of the services on a case by case basis; or (ii) for other services, the provision of the services is authorised by the competent national authority.

“The value of statutory audit for the audited entity would be particularly enhanced if the communication between the statutory auditor or the audit firm, on the one hand, and the audit committee, on the other hand, was reinforced.”

Proposed Regulation

This (non-exhaustive) list of proposed changes at EU level demonstrates the leading role taken by the European Commission in the debate on statutory audit and corporate governance. Given the large amount of attention paid to this topic in the EU Proposed Regulation, it may be advisable to wait until the European measures take effect before altering the Belgian rules in this respect.

(iii) Guidance and additional recommendations

Even though the emphasis on the audit is likely to be increasingly in hard law, a corporate governance code can still contain recommendations on the audit. These recommendations can (i) repeat, develop and provide guidelines on the legal provisions (so as to provide a good overview of existing corporate governance rules) or (ii) provide additional recommendations or guidance on the implementation of the legal provisions.

The Belgian 2009 Code contains recommendations that are similar to the legal provisions (and which refer to the corresponding legal provision) and also includes guidance and additional recommendations.⁶⁶ Also, the practical rule for the procedure regarding the nomination and re-election of the external auditor in order to guarantee the quality and transparency of the external audit, issued in June 2012, provides guidance in supporting recommendation 5.2/20 of the Belgian 2009 Code.

Positioning the studied jurisdictions’ codes on this topic is difficult, as rules are spread over different instruments of hard law and soft law. However, it seems that an upgrade of the Belgian 2009 Code or the issuance of an additional practical rule could be considered, especially having regard to the recently updated UK Guidance on Audit Committees. Irrespective of the legislative mechanics and leaving aside measures that are contained in the Proposed Regulation, below are a few possible additional recommendations which may be included in the Belgian 2009 Code and are set out by way of example.

- The annual report could be required to include an explanation of how the committee has assessed the effectiveness of the external audit process and of the approach taken to the appointment or reappointment of the external auditor, in order that shareholders can understand why it recommended either to reappoint or change the auditors.⁶⁷

⁶⁶ An example of an additional recommendation is that the Belgian 2009 Code states that the board should satisfy itself that the audit committee has sufficient relevant expertise, notably in accounting, auditing and finance, to fulfil its role effectively (whereas the law does not contain a similar collective expertise requirement for all listed companies). Examples of guidance can be found in, for example, the chapters on the monitoring of the financial monitoring process and of the effectiveness of the internal control and risk management systems in Appendix C of the Belgian 2009 Code.

⁶⁷ Provision 4.26 of the UK Guidance on Audit Committees

- The audit committee could be asked to approve the terms of engagement and the remuneration to be paid to the external auditor in respect of audit services provided.⁶⁸
- The audit committee could be asked to develop and recommend to the board the company's policy in relation to the provision of non-audit services by the auditor, and keep the policy under review.⁶⁹

These additional recommendations may be included in the Belgian corporate governance code, or in another practical rule or separate guidance note. However, in this domain even more than in the others, any changes at the local level may overlap with some of the prospects of action at EU level. Moreover, the changes are still subject to (quite some) debate.

The current emphasis on statutory audit regulation is clearly on addressing issues in hard law. We perceive an important trend towards EU harmonisation, with proposals for direct effect regulation.

But corporate governance codes may still have some importance in the domain of statutory audit, for instance in (i) developing and providing guidelines on legal provisions and (ii) providing additional recommendations. However, in our view, Belgium does not yet need to alter the existing code provisions regarding statutory audit, for the following two reasons:

- in view of the expected EU amendments, the authors of the codes may want to await for the EU initiatives to take effect; and
- with respect to the current situation in Belgium, although a few changes could be proposed which are not covered by the current EU proposals, those changes do not, in our opinion, require urgent action.

(f) The role, capacities and powers of the chairman of the board of directors

The presence of a controlling shareholder, the increasingly important role of the audit committee and the external auditor, the move towards more diversity in the profiles of the directors, the presence of independent directors and the more active involvement of shareholders in the governance of a company are all elements stimulating a 'culture of debate'. However, at the same time these elements complicate decision making by the board of directors and thus give the chairman of the board of directors a key role in the decision making process.

The potential role of the chairman of the board is varied. He or she can act as an intermediary between shareholders and board members, as a spokesman and representative of the board, as a moderator and facilitator of debates, as an arbitrator etc. Usually the chairman performs an underlying role of 'equilibrist', balancing different opinions and interests.

"It is, above all, the chairman who sets the tone and orchestrates the interactions and workings of the board's individual members."

2011 Heidrick & Struggles

Indeed, as the EC puts it in its 2011 Green Paper, the role played by the chairman seems to have a considerable impact on the board's functioning and success in many respects. The 2011 Green Paper further states that, in view of this impact, it could be useful to define the position and responsibilities of the chairman of the board more clearly. However, at this stage it is not clear exactly what position or responsibilities the EC is contemplating.

Awaiting further EU action, we set out below a brief overview of the chairmen's role in studied jurisdictions: Belgium, France, Germany, Italy, the Netherlands and, the United Kingdom.

⁶⁸ Provision 4.27 of the UK Guidance on Audit Committees

⁶⁹ Provision 4.38 of the UK Guidance on Audit Committees

- **Organisation of board meetings:** all of the studied codes, except for the Middlednext Code, give the chairman a leading role in the preparation of board meetings. However, the extent of the description and the scope of this role varies. The most summary recommendations, eg in the AFEP MEDEF Code, refer only to the chairman’s role to provide information to the directors. Most codes (including the German, the Dutch, the UK and the Belgian codes) also refer to the co-ordination role, ensuring proper functioning of the board of directors. The most detailed codes, i.e. the UK CG Code and the Belgian 2009 Code, include tasks such as the setting of the agenda, and following up on the implementation of decisions.
- **Interaction with the management:** all of the studied codes, except the French CG Codes, provide an important role for the chairman liaising with the management. There are slight nuances in the approach and the aim of the interaction (eg “*consulting with*” the management in the German CG Code vs “*providing support and advice*” to the CEO and “*promoting effective interaction*” between the board and the executive management in the Belgian 2009 Code), but the chairman is generally viewed as the point of contact between the non-executive directors and the executive directors. All of the studied codes contain recommendations which relate to the separation of the role of the CEO and the chairman of the board of directors.⁷⁰
- **Promoting the ‘culture of debate’:** all of the studied codes, except for the French CG Codes and the German CG Code, make reference to the chairman’s role in the debate. The Italian CG Code and the Dutch CG Code only state that the chairman should ensure that there is sufficient time for effective consultation, discussion and decision making, whereas the more detailed codes (the UK CG Code and the Belgian CG Code) also add express reference to the promotion of the culture of openness and debate, allowing constructive dissent and developing a climate of trust.
- **Organisation of the shareholders meeting:** most of the studied codes, except for the French CG Codes and the Italian CG Code, provide some role for the chairman in conducting or providing information to the general shareholders meeting.
- **Induction for directors:** all of the studied codes, except for the French CG Codes and the German CG Code, require the chairman to ensure that new directors receive an appropriate induction.
- **Evaluation of the board of directors:** four of the studied codes, ie the Middlednext Code, the UK CG Code, the Dutch CG Code and the Belgian 2009 Code, give the chairman a role with regard to the evaluation of the board of directors.
- **Spokesperson:** only two of the studied codes, ie the Dutch CG Code and the UK CG Code refer to the chairman’s role as spokesperson of the company. The Dutch CG Code states that the chairman acts on behalf of the supervisory board as the main contact for shareholders regarding the functioning of the management and supervisory board members. The UK CG Code sees it as a task of the chairman to discuss governance and strategy with the major shareholders and to ensure that the views of the shareholders are communicated to the board as a whole.
- **Appointment of directors:** only two of the studied codes, the UK CG Code and the Belgian 2009 Code, recommend that the chairman (or another non-executive director) leads the nomination process for new directors.

⁷⁰ The Italian CG Code refers to the designation of a ‘lead independent director’ in the event that the chairman is the chief executive officer of the company. The AFEP MEDEF Code states: “*The corporations with a board of directors have an option between separation of offices of chairman and chief executive director and maintenance of the aggregation of such duties. The statute does not favour either formula and allows the board of directors to choose between the two forms of exercise of executive management. It is up to each corporation to decide on the basis of its own specific constraints.*”.

- **Capacities of the chairman:** only two of the studied codes, the UK CG Code and the Belgian 2009 Code, mention the fact that the chairman should be appointed on the basis of availability and capacity to perform the above roles (such as knowledge, skills, experience and mediation strengths).

Country / Role	AFEP MEDEF Code	Middlenext Code	German CG Code	Italian CG Code	Dutch CG Code	UK CG Code	Belgian 2009 Code
Organisation of meetings of the board	V	–	V	V	V	V	V
Interaction with management	–	–	V	V	V	V	V
Promoting the ‘culture of debate’	–	–	–	V	V	V	V
Organisation of shareholders’ meetings	–	–	V	–	V	V	V
Induction for directors	–	–	–	V	V	V	V
Evaluation of the board	–	V	–	–	V	V	V
Spokesperson of the board	–	–	–	–	V	V	–
Appointment of directors	–	–	–	–	–	V	V
Capacities of the chairman	–	–	–	–	–	V	V

The above overview shows that the French CG Codes have very few recommendations relating to the role, powers and capacities of the chairman. The UK CG Code and the Belgian 2009 Code are clearly the frontrunners in this respect.

However, whether a corporate governance code contains many provisions on the role and capacities of the chairman depends again on the national legal context, the predominant ownership structure⁷¹, the predominant board structure, etc. The above overview must also be read and understood in this perspective.

Elements that showed up in the comparison between the studied jurisdictions, that are particularly noteworthy within the scope of this study are:

- In its preface, the UK CG Code refers to the chairmen's specific role with regard to corporate governance. It states: *“Chairmen are encouraged to report personally in their annual statements how the principles relating to the role and effectiveness of the board have been applied. Not only will this give investors a clearer picture of the steps taken by boards to operate effectively but also, by providing fuller context, it may make investors more willing to accept explanations when a company chooses to explain rather than to comply with one or more provisions. Above all, the personal reporting on governance by chairmen as the leaders of boards might be a turning point in attacking the fungus of “boiler-plate” which is so often the preferred and easy option in sensitive areas but which is dead communication.”*
- The UK CG Code further states that on appointment the chairman should meet the criteria set out for independent directors. In this respect, we note that the 2011 Heidrick & Struggles Study⁷² demonstrates that Belgium, when compared to other European countries, has a relatively high number of non-independent chairmen (50% non-executive non-independent chairmen, whereas the 2011 European average is 33%).

The chairman of a board, as 'primus inter pares', may have a considerable impact on the functioning of the board and on the communication with the shareholders. The role may range from technical and concrete tasks (eg setting the board's agenda, leading the evaluation of the board) to more general duties (eg building trust, stimulating team dynamics and encouraging a culture of openness and debate) and is increasingly important in the increasingly complex corporate governance environment.

The chairman will usually play an important role in the information flow within the company (ie in providing information to the other board members, the management and the shareholders). This role is likely to become even more important with the enhanced emphasis on dialogue between the management and the board (internal governance), between the board and the auditor and between the board to the shareholders.

In some jurisdictions, including Belgium and the UK, the chairman also plays a organisational role in several aspects, both with respect to the meetings of the board and to shareholders' meetings, and has a duty to actively stimulate the culture of debate within the board.

In the Belgian 2009 Code, the role of the chairman has been set out quite extensively. Belgium could draw inspiration from the example of the UK where the chairman's role is even more developed, eg with respect to independence and the role of spokesperson. In our view, however, changes to the Belgian 2009 Code regarding the role, powers and capacities of the chairman are not pressing.

⁷¹ The Italian CG Code refers to the designation of a 'lead independent director' in the event that the office of the chairman is held by the person controlling the issuer.

⁷² 2011 Heidrick & Struggles Study, p52.

4. Conclusion

Even though the Belgian 2009 Code is one of the oldest codes of the studied jurisdictions and despite the fact that the European corporate governance landscape has been quite vibrant lately, it appears to us that it is not yet absolutely necessary to amend the Belgian 2009 Code. In compiling the study, we have distilled four considerations which, when read together, lead us to this conclusion.

- Firstly, Belgium has largely implemented the European directive provisions on corporate governance and is, overall, diligently implementing European corporate governance requirements and recommendations. Moreover, there are no material inconsistencies between Belgian law and the Belgian 2009 Code. From this perspective, although we can identify some areas where changes might be made, changes to the corporate governance rules are not pressing.
- Secondly, as far as best practices are concerned, in many respects Belgium is already in line with current trends. In those areas where it is not, it may be preferable to wait for current European initiatives to be turned into regulations or directives, or to consider preparing a separate code or guidance note rather than amending the Belgian 2009 Code. We find that Belgium is generally perceived within the EU to be above average, and for some areas is even considered a frontrunner, in the field of corporate governance.
- Thirdly, throughout the study we have observed that the most important topics which do deserve to be developed in governance rules (such as shareholder involvement) would fit better into a separate code or guidance note, rather than in a corporate governance code.
- Fourthly, a very detailed and extended code does not necessarily entail, and may even negatively affect, the implementation of the code's provisions. In addition, in order to ensure a good take-up of corporate governance rules, companies should be given the time to digest the rules (and monitoring institutions should take their time to read the results of the compliance monitoring process and to put them into perspective). Several major players in the European corporate governance landscape have expressed their desire to reduce administrative burdens imposed on listed companies and to allow sufficient time between amendments.

We perceive a trend both in the recent and envisaged changes to the codes of neighbouring countries, and in EU proposals, towards placing corporate governance in a broader context. Rules and recommendations are not only addressed to boards, but also to shareholders, to individual directors, to management and to auditors.

However, before integrating each and every new development and continuing to tinker with and polish the code, one needs to reflect on the scope of corporate governance and on the 'audience' of a corporate governance code. In our view, a corporate governance code primarily addresses companies and boards on corporate governance, which can be distinguished from shareholder governance, internal governance, individual directors' duties and auditors' tasks.

Corporate governance is just one piece in a broader governance spectrum. Indeed, all the other pieces of that spectrum (including shareholders, individual directors, management, auditors and others stakeholders) are equally important in developing an advanced governance environment, but those elements must not necessarily be addressed in a corporate governance code. Other tools for the other focus groups may be more adequate.

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