

EASD CORPORATE GOVERNANCE  
COMMITTEE

# CORPORATE GOVERNANCE

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PRINCIPLES AND RECOMMENDATIONS

12 APRIL 2000

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## P R E F A C E

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EASD – the European Association of Securities Dealers – was conceived as a non-profit institution in 1994. It associates financial intermediaries with lawyers, accountants, investor relations specialists and other professionals intent on promoting pan-European equity market efficiency that facilitates the access of entrepreneurs to public funding.

In this perspective, EASD has stood behind the creation of EASDAQ, the pan-European electronic stock market for fast-growing, internationally oriented companies, which started operations in November 1996.

EASD's aims include providing its members with a forum for exchange of views and reflection, setting pan-European market standards and fostering changes in regulations and rules that inhibit pan-European securities trading.

To fulfil its role, EASD has established a number of committees that help and advise it on specific aspects of its mission. One of these aspects is corporate governance which benefits companies by improving access to external funds, enhancing share liquidity and reducing cost of capital.

The EASD Corporate Governance Committee was first convened in January 1997. It has seven members, a legal advisor, and a scientific advisor and rapporteur, all designated by EASD's board of directors and serving *pro bono*. The European brief of the committee is reflected in its geographical composition (list, annex 1).

The committee and its representatives are active in the theoretical and practical corporate governance debate that has been intensifying world-wide over the past years<sup>1</sup>.

The committee also offers advice, such as that given to EASDAQ on the corporate governance prescriptions of its rule-book.

But its main activity during the past three years has been the preparation of the present corporate governance Principles and Recommendations. In the process, a wide variety of national and international authorities, organisations and specialists from Europe, but also from America and Asia, were consulted and EASD wishes publicly to record its gratitude to each of those who accepted to comment and who

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<sup>1</sup> Amongst others, they have responded to surveys, such as the European Commission hearings on company law and corporate governance in 1997 and participated in academic fora such as the European Corporate Governance Network, as well as in international endeavours such as the OECD Task Force on corporate governance in 1998-9 and thereafter in World-Bank-OECD Corporate Governance Round Table work in emerging markets.

thereby contributed to the reflections of the committee (acknowledgements, annex 2).

The final text was approved on 3 March 2000 in Stockholm by EASD's Board of directors. It alone bears responsibility for the contents.

It is hoped that companies will wish to state their adhesion to these Principles and Recommendations, it being understood that there can occur particular situations or circumstances where one or the other of the recommendations might be deviated from. That would be in order as long as it is appropriately disclosed and explained<sup>2</sup>.

For the future, this document will be maintained under review and updated in line with developments.

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<sup>2</sup> To be noted that in this spirit, EASDAQ's Board of directors and Market authority have already decided to adopt the document and append it to its market rule-book, as a desirable standard for EASDAQ-listed companies.

# CORPORATE GOVERNANCE

## PRINCIPLES AND RECOMMENDATIONS

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## PREAMBLE

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### STOCK MARKETS, CORPORATE GOVERNANCE AND LIQUIDITY

Stock markets flourish when they provide liquid investment opportunities and a well-regulated trading environment. They enable companies to raise equity capital and grow. Liquid stocks have lower transaction costs (spreads) and investors demand – other things being equal - lower expected returns; it is cheaper for companies to raise capital through liquid issues and markets.

However, raising external finance and maintaining liquidity can be difficult, particularly when investors have insufficient confidence in the corporate governance procedures and standards of the companies concerned. Adherence to internationally accepted corporate governance standards can help to bridge this confidence gap.

A broad shareholder base, a necessary condition for maintaining liquidity, can also generate corporate governance problems. Individual shareholders might not exercise their rights to vote, or voting rights might be concentrated in the hands of a few who hold less than proportional cash-flow rights. Corporate governance standards contribute to overcome these problems.

### EASD'S PRINCIPLES AND RECOMMENDATIONS

The Nineties have witnessed the formulation of a wide variety of corporate, governance principles, recommendations and codes. These are referred to in an appendix (Corporate Governance Initiatives, page xxx).

The EASD Principles and Recommendations presented here are pan-European in scope and thus have a broader outlook than most national documents. They are also more detailed than other international initiatives, for example the OECD Principles. But they do not stand in isolation and therefore a considerable degree of overlap with existing principles, recommendations and codes is inevitable, desirable and deliberate.

The EASD Principles and Recommendations are essentially addressed to companies, investors and stock markets. Although they occasionally refer to international regulatory standards, such as auditing and non-financial disclosure standards, they do not go into the same level of specialised detail as, for example, IOSCO or FESCO standards which have a different focus.

The Committee has predicated its overall approach on the general premise that in market economies, companies should strive to achieve long term viability while optimising returns for shareholders over time.

In its reflections, it has addressed the distinction between the "interest of the company" and the collective interest of shareholders as owners of its capital, and examined the implications of this distinction on stakeholder issues.

Indeed, many jurisdictions specifically identify "company interest" as such for a variety of reasons.

Owners do not necessarily have absolute rights over the object of their ownership, and in many instances society imposes limits on what can be done to or with it. This applies particularly to companies, which are evolving organisms marshalling the inputs of various constituencies.

Companies are also *de jure* and *de facto* entities separate from their shareholders. Shareholders interest is itself diverse since various shareholders as individuals or groups have different objectives.

Finally, companies pursue a variety of roles and objectives in the societies in which they are active. The societal dimension is gaining increasing attention from companies, investors and public opinion.

Yet governing organs of companies cannot be held accountable to all stakeholders in the company - shareholders, staff, clients, suppliers, credit providers, as well as the communities and the environment in which they operate - lest accountability be fragmented, subjected to contradictory aims and thereby diluted. The Committee therefore espoused the view that corporate governing organs should be accountable to the shareholders, the more so since they are the residual bearers of risk of the company as owners of its equity. However company organs should also be responsible for properly addressing the concerns of other legitimate stakeholders. Such attention evidently promotes the best interests of the company itself in the long term

While it is not for the Committee to recommend what particular objectives and structures companies and investors should set themselves and how they are best to be pursued, the Committee does endorse the view that investors should play an active role in the corporate governance of the companies in which they invest and make a considered use of their votes.

The EASD corporate governance principles do not address the issue of the harmonisation of European company law and securities regulation. Numerous systems exist in the European Union sometimes leading to far-reaching differences in corporate structures involving participating constituencies and governing organs

in various ways. European diversity is a fact that must be duly recognised<sup>3</sup>, even as it complicates matters in comparison with other country groupings that can rely on more uniform basic legal and cultural backgrounds. Nevertheless, there are a number of underlying general corporate governance principles that apply, or should apply, to all companies that want to attract investors through well-regulated and liquid stock markets. The EASD Corporate Governance Committee has concentrated on these principles.

#### EUROPEAN CORPORATE GOVERNANCE

European corporate governance recommendations must take into account the realities of the situation in various countries. Corporate governance practices in continental Europe often differ from those of countries that have broad and liquid stock markets, such as the United States and the United Kingdom.

Recent research on voting power concentration shows that in the United States more than half of the New York Stock Exchange and NASDAQ listed industrial companies do not have a single 5%+ beneficial owner; management control is common. By contrast, in Austria, Belgium, Germany and Italy more than half of the listed industrial companies have a 50%+ beneficial owner; blockholder control is common. In the United Kingdom, half of listed companies have a 9.9%+ blockholder; there is the potential for coalition control.

In Europe, control of a company is not usually relinquished in initial public offerings, voting rights are only surrendered partially (or sometimes not at all, e.g. by floating non-voting stock only). After the IPO, control is only given up in stages and more rapidly in some countries (for example the United Kingdom) than in others (such as Germany).

Hence, three stylised paths of selling ownership and control on stock markets can be distinguished:

1. Cash-flow rights and voting rights are widely dispersed; the market for both rights is liquid and control is relinquished.
2. Cash-flow rights are widely dispersed and the initial shareholder uses a legal instrument to retain or lock-in control, e.g. issues non-voting stock, or certificates through a trust company; imposes voting right restrictions; the market for cash-flow rights is liquid but control cannot be contested.

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<sup>3</sup> Particular care has been taken in drafting these recommendations with a view to making them as adaptable as possible to different situations, such as where boards are one or two tiered. Thus - except in rare instances that are flagged (sometimes with expressions like "subject to legal constraints") - the term "board" equally refers to a board of directors or a supervisory board, ; it does not include management boards such as the *Vorstand* in Germany.

3. Few of the cash-flow rights and voting rights are sold; trading is illiquid since the stock lacks a broad shareholder base.

Different governance problems arise in each situation which are briefly reviewed below.

1. A broad shareholder base is an advantage in terms of liquidity, but can pose serious corporate governance problems; when ownership and voting power are dispersed, individual investors often feel they do not have an incentive to monitor the managers they employ. Boards can be weak and dominated by management, in particular by the CEO. Disclosure, performance pay, distinguishing executive and non-executive functions, independent directors<sup>4</sup>, institutional shareholder voice, leveraged buyouts and control contests are some of the standard tools resorted to for solving the shareholder collective action deficiencies that arise from dispersed ownership and voting power.
2. When cash-flow rights are sold but control is retained in a few hands, the nature of the monitoring problem changes. The controlling blockholder has and uses the power and the means to monitor management. However, concentrated voting power brings about corporate governance problems of its own: the potential for majority abuse of minorities who find it difficult to monitor and challenge the blockholders. Boards too can be dominated by controlling blockholders, and directors or managers do not necessarily have the will or the possibility, where warranted, to oppose them. Furthermore, in most cases, control shifts cannot occur without the consent of the controlling blockholder. When control is locked in; similar problems arise. Here also, many of the above-mentioned solutions will provide checks and balances with the important exception of control contests, for which adequate and enforceable minority rights may provide a substitute.
3. When few cash-flow rights and voting rights are sold, the absence of a liquid market (exit opportunities) adds to the problems associated with concentrated control.

Control without ownership can foster inappropriate attitudes; control accompanied by ownership tends to reduce stock market liquidity.

#### EASD'S APPROACH

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<sup>4</sup> To avoid any confusion, it should be recalled that "independent" directors are a sub-group of "non-executive" directors : not all non-executive directors are independent - such as appointees of major blockholders or staff, or directors who have material ongoing service contracts with the company.

The pan-European EASD principles and recommendations had the difficult task of addressing these various situations, while keeping in mind the objective of stock market liquidity. The committee's overall approach has been to define principles that adequately express the legitimate concerns of the different parties involved and make recommendations that stimulate the confidence of investors and the companies they invest in.

To overcome the co-ordination and monitoring problems that can arise when ownership and voting rights are dispersed, the committee has endorsed many views which promote the role of independent directors, the importance of corporate voting, the ability to vote by proxy and the possibility of conducting contested takeovers. It is likely that further sales of control will lead more companies to possibly broader dispersed ownership and it is important that markets have the appropriate provisions in place for dealing with the problems that can arise.

The principles favour "one-share-one-vote" because it provides all shareholders with a greater incentive to participate in the decision making process, furthering more closely the interests of the company as a whole: to wit the "one-share-one-vote" principle is strongly endorsed by institutional investors who wish to have voting rights proportional to the cash-flow rights they acquire. However, this principle must be weighed against the wish of initial shareholders or blockholders to retain control. When control is valued highly and regulation imposes "one-share-one-vote", the shareholder base is often thin and it is likely that there will be no liquid market for the company's stock.

The committee notes the choice of entrepreneurs who mainly wish to sell cash-flow rights, at least initially. In this context, deviations from "one-share-one-vote" are sometimes used. This is because they allow entrepreneurs to broaden the shareholder base of their company while at least for the time being retaining sufficient control and motivation to pursue their project according to their original concepts, the success of which has induced new shareholders to join them. However, the concerns of the cash-flow rights holders, who have less than proportional voting rights, must be taken into account. The committee has addressed these concerns, in particular by stressing the role of boards *vis-à-vis* all shareholders, not just the founders or controlling blockholders and the role of independent board members.

The committee also notes that in certain instances, founders and controlling blockholders may and do consider other objectives to override shareholder return maximisation, such as social, economic and environmental contributions in general or to the area where the company is located. To ensure that these other aims can be pursued over time, some companies seek immunity from measures such as takeover bids that would increase the value of the company by eliminating such overriding objectives. It is clear that where founders or controlling shareholders

make such choices and take such measures, these must be properly disclosed and explained.

#### CLOSING REMARKS

In this document, the principles are of a more reflective nature. In contrast, the recommendations, mainly inspired by business experience of governance problems and remedies, are more “down-to-earth” and provide practical suggestions for implementation.

It will be noted that several principles and numerous recommendations mention disclosure, which begs the question : to whom? Where not otherwise specified, disclosure refers to information printed, electronically distributed or made available through the media, to the shareholders at large in the form of annual reports, financial statements, prospectuses, announcements, etc.

The development of these principles and recommendations should not as such be construed as the indication of a lack of positive regulation in the field of corporate governance. While a coherent core of fundamental rules are a necessity for the proper functioning of companies and markets, overregulation can be counterproductive, the more so since rules cast in the stone of law - often as a result of particular political circumstances - can prove to be extremely difficult to modify in a proper and timely fashion when they outlive their purpose. Corporate governance is showing itself to be an evolving discipline, over time and space, applicable as it is to very different situations : it is in the nature of principles and recommendations such as these to be kept under flexible continuing review in contact with the realities of economic activity and under the benefit of co-operation with organisations which devote their reflections to the subject of corporate governance.

In drawing up the recommendations, the committee has not followed an exhaustive approach. Recommendations are by essence not prescriptive. Indeed, there will exist circumstances, according to the size, stage of development, type of activity and nature of the shareholder structure of a company where deviations from the recommendations may be acceptable or even desirable - yet another reason to keep them flexible. Such instances and their reasons should be duly disclosed. In any event, some of the recommendations are deemed to have sufficiently universal applicability, and to underscore them, the word “must” has been used in preference to the more general “should”.

Finally, it is expected that those scrutinising the compliance of a company will not adopt a narrow “box-ticking” approach in a purely “yes or no” evaluation of a company's application of these recommendations, but will have due regard to the justifications given for particular circumstances invoked.

As always in such cases, it is not necessarily the letter of the recommendations that counts but their spirit.

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## PRINCIPLES

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- I.** Shareholders enjoy basic rights, which should be protected. They have a right to adequate and timely information and appropriate forms of participation in certain decisions affecting the company and themselves.
- II.** Shareholder voting should be encouraged and collective action problems should be solved through appropriate mechanisms.
- III.** Deviations from “one-share-one-vote” should be avoided and, where they exist, must be disclosed.
- IV.** Controlling shareholders should give due consideration to the interests of minority shareholders. Minority shareholders should not unreasonably restrain corporate action.
- V.** Pursuing the long term interest of the company, boards<sup>5</sup> are agents who perform orientation and monitoring functions for which they are accountable to all shareholders. The board’s working and procedures should facilitate the achievement of these functions.
- VI.** Board and board committee composition should be balanced and their nomination and remuneration policies transparent.
- VII.** Management should have sufficient latitude to propose and implement corporate strategy. Its incentives should, as far as possible, be aligned with those of the company and its shareholders as a whole.
- VIII.** Relevant, timely, accurate and understandable disclosure should be made of material information necessary for the proper evaluation of the status and the situation of the company. Internal controls should provide for the integrity of corporate data. Independent verification and certification of the existence of appropriate controls and the

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<sup>5</sup> See note 3.

integrity of data, in particular disclosed information, should be obtained to the fullest extent feasible.

- IX. Conflicts of interest should be avoided and where they can not, must be properly managed and disclosed.
  
- X. The market for corporate control should be allowed to function in an efficient and transparent manner. Take-over barriers should not shield management, the board and influential shareholders from accountability.

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## RECOMMENDATIONS<sup>6</sup>

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**I. Shareholders enjoy basic rights, which should be protected. They have a right to adequate and timely information and appropriate forms of participation in certain decisions affecting the company and themselves.**

*1. Basic shareholder rights include:*

- a. having secure methods of ownership and transmission, and proof thereof;
- b. receiving relevant, timely and regular information on matters of concern to them;
- c. participating and voting in shareholder meetings, in particular to decide on fundamental changes in the company or in shareholders' rights, e.g. modifications to articles of association, by-laws and similar organic documents of the company, authorisation of issuance of additional shares or other dilutive schemes like stock-option plans, extraordinary transactions involving the merger of the company or the sale of all or a substantial part of its assets, and the dissolution of the company;
- d. electing and removing members of the board and approving of the external auditors, subject to legal constraints;
- e. sharing in profits.

*2. Shareholders should have timely and practical access to information on the rules and voting procedures relating to meetings. Substantially different subjects should be voted on separately.*

Shareholders should receive sufficient notice and information on meeting location, date, agenda and issues to be discussed, with the ability to request items to be placed on the agenda and to ask questions, subject to reasonable limitations.

The Chairman should be present at shareholders' meetings to answer questions or to refer them to appropriate members of the board (such as committee chairmen) or management, who should also hold themselves available for that purpose.

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<sup>6</sup> EASD's Corporate Governance Principles are shown in bold type.

After shareholders meetings, shareholders should have prompt and practical access to information on the substance of the discussion and the results of the vote.

3. Steps should be taken to promote shareholder rights, impediments to the exercise of shareholder rights should be removed and shareholders should be given possibilities to seek redress for violation of their rights.

## **II. Shareholder voting should be encouraged and collective action problems should be solved through appropriate mechanisms.**

1. Excessive costs and other administrative or practical impediments to shareholders participating in meetings and/or voting in person or otherwise should be removed.

Electronic filing and distribution of shareholder information necessary to make informed decisions are strongly encouraged, subject to legal constraints. Likewise video-conferencing and electronic voting are encouraged, also subject to legal and security constraints and where warranted to adequate confidentiality procedures.

2. Voting by proxy
  - a. Voting by proxy and the solicitation of votes should be encouraged and formalised.
  - b. Proxy solicitation mechanisms should be fair and not favour any party.
  - c. Proxy solicitation should be efficient and inexpensive.
  - d. Shareholders should be provided with timely information describing in sufficient detail the issues to be discussed and voted on.
3. Custodians (not including those with an official mandate such as trustees, estate executors or receivers), whether or not they have a conflict of interest
  - a. must provide the shareholder with a list of issues on which the voting is foreseen and the manner in which the custodian proposes to vote;
  - b. must inform the shareholder when they have a conflict of interest;
  - c. must provide the shareholder with a list of institutions that could alternatively vote his/her shares;
  - d. must not vote shares unless they have received instructions from the shareholder, which nevertheless can take the form of a general mandate to vote, yet limited in time.

#### 4. Institutional investors

Institutional investors acting in a fiduciary capacity for external beneficial owners should state their voting policies.

### **III. Deviations from “one-share-one-vote” should be avoided and, where they exist, must be disclosed.**

1. Deviations from “one-share-one-vote” brought about by mechanisms that induce voting rights disproportional to cash-flow rights, such as multiple vote shares, voting caps, the use of multiple legal devices, the use of cross-holdings, as well as overly complicated statutory provisions are discouraged.
2. If they exist, they
  - a. must not apply within a single class of shares;
  - b. must be simple and easy to understand;
  - c. must be disclosed and explained.
3. Ownership cascades that procure a degree of control disproportionate to individual equity ownership and significant shareholder agreements should be disclosed.<sup>7</sup>

### **IV. Controlling shareholders should give due consideration to the interests of minority shareholders. Minority shareholders should not unreasonably restrain corporate action.**

1. Minority shareholders' interests must be protected by ensuring that
  - a. the rules and procedures of ordinary and extraordinary shareholder meetings provide for appropriate safeguards as foreseen under Principle I.
  - b. due regard is given to their rights and concerns by the board and management;
  - c. appropriate rules and procedures concerning conflicts of interest exist as foreseen under Principle IX.

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<sup>7</sup> Thresholds for significant holdings vary throughout Europe. The committee recommends that agreements providing for aggregate voting power or preemption rights relating to 3 % or more of any class of shares should be disclosed.

2. Without prejudice to legal remedies, minority shareholders should be able to raise concerns affecting their interests by petitioning the board and/or the relevant authorities.
3. Meetings of shareholders should not be subject to interventions designed to hamper their proper process.

**V. Pursuing the long term interest of the company, boards<sup>8</sup> are agents who perform orientation and monitoring functions for which they are accountable to all shareholders. The board's working and procedures should facilitate the achievement of these functions.**

1. Responsibilities

- a. Boards are fiduciaries who must act in the interest of the company<sup>9</sup> and its shareholders as a whole, in good faith, with due diligence, care and loyalty, and on an appropriately informed basis.
- b. Boards are responsible for ensuring that the company's stakeholders' rights are respected and their concerns addressed, and that policies in this respect are developed.
- c. Boards must be capable of exercising objective judgement on the company's affairs, independently of management and particular interest groups.
- d. Board members should be able to devote sufficient time to the proper exercise of their responsibilities.

2. Key areas of concern

These should, at least, include: objectives, strategy, risks, major acquisitions and investments, accounts and budgets, performance, corporate governance, stakeholder policies, senior executive nomination, remuneration and succession planning, conflicts of interest, corporate ethics and behaviour, audit and control systems, disclosure and communication of information.

3. Chairman

- a. Functions

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<sup>8</sup> See note 3

<sup>9</sup> See Preamble, page 2

- i. The Chairman should ensure that the board operates efficiently and that its duties are effectively carried out.
  - ii. The Chairman should set the agenda of board meetings taking into account items raised by members and management, subject to legal constraints.
  - iii. The Chairman should arbitrate governance conflicts in the first instance.
  - iv. It should be the Chairman's responsibility that adequate and timely information is provided to board members ahead of meetings, and where necessary in between.
- b. In one-tier board systems the positions of chief executive officer and chairman of the board should preferably be distinct, subject to legal constraints; if not, the company should disclose and explain its decision.

#### 4. Board secretariat

The Board should appoint (and when necessary itself remove) a person charged with recording the minutes and monitoring conformity with board procedures, implementation of policy decisions, and follow-up.

#### 5. Working of the board

- a. Number of meetings
  - i. The board should meet sufficiently frequently to discharge its duties responsibly; it must meet at least once every six months and should meet at least once every three months.
  - ii. The number of meetings held should be disclosed.

- b. Subject of meetings

The board should define the subjects that it must consider, as well as the decisions that require its approval, and set levels of materiality for them, subject to legal and statutory constraints.

- c. Attendance

The names of the directors who did not personally attend at least 75% of the meetings should be disclosed.

- d. Call and Notice

- i. Meetings should, if possible, be planned well in advance.

- ii. A minimum of eight working days notice should be given before any meeting barring emergencies.
  - iii. A quorum of board members should be entitled to call a meeting.
- e. Agenda, Documentation and Minutes
- i. Every director should have the right to propose items for the agenda of the meeting.
  - ii. It should be up to the board to accept items suggested by its members.
  - iii. Background information should be given for the meeting. The material should be clear, sufficient, relevant and timely.
  - iv. The minutes must include any point made by a member if so requested.
- f. Individual relations

The board should adopt a “statement of practice” for its internal dealings and for communicating with persons or institutions inside or outside the company.

In particular, board membership should observe confidentiality in respect of board activities and related information.

## 6. Evaluation and review

Evaluation and review procedures on the effectiveness of the board and its members should be established and their existence disclosed.

## **VI. Board and board committee composition should be balanced and their nomination and remuneration policies transparent.**

### *I.* Balance

- a. No person or group of persons should be in a position to exercise unfettered powers.
- b. There should be a sufficient number of board members of character and skill who are independent of management, influential shareholders and other conflicting interests, such as staff, the state or suppliers of goods and services to the company and its group.

## 2. Nomination

- a. The nomination process and criteria for board and board committee members should be disclosed, in particular with respect to independent board members.
- b. Once elected, board members should be properly inducted in the company's affairs.
- c. Board members should stand for individual re-election on a regular basis.
- d. If a board member leaves the board on the grounds of policy disagreements, an opportunity should be provided for a fair account to be given to shareholders, subject to commercial sensitivity considerations.

## 3. Board remuneration

- a. Board remuneration should be sufficient to attract and retain members of the quality needed for the successful accomplishment of their tasks.
- b. Non-executive board members' remuneration should be determined according to principles and policies of the board and its relevant committee, which should be disclosed.
- c. Material elements of non-executive board members' remuneration including their participation in pension arrangements, stock-option plans or incentive schemes of whatever nature should be meaningfully disclosed at least in the aggregate.
- d. It is not improper for independent board members to own some shares of the company but they should not participate in stock option or pension plans. Nevertheless stock options may be acceptable in early stage companies before they are listed.

## 4. Committee Composition

- a. There should be a majority of independent board members on all board committees where there is a potential for conflicts of interest.
- b. The chairman should be a non-executive board member for all committees; in addition, for the audit and the remuneration committee he or she should be independent.

## 5. Working of Committees

- a. Terms of reference should be drawn up for each committee laying down its authority and its duties.
- b. For the functioning of committees, the same guidelines as for the board as a whole should apply with the exception of composition.

**VII. Management should have sufficient latitude to propose and implement corporate strategy. Its incentives should, as far as possible, be aligned with those of the company and its shareholders as a whole.<sup>10</sup>**

1. It is the function of management to run the business of the company in accordance with the strategies, policies and criteria defined.
2. Management is accountable to the board, the company and its shareholders as a whole. It reports to them on a regular basis.
3. Within their obligation to pursue the common corporate interest and their duty of loyalty and fair dealing, management should have a sufficient degree of autonomy within limits set by law and regulations, statute/by-laws, contracts, and where applicable delegation of power and decisions as defined by the board.
4. Delegation
  - a. The board should determine the powers delegated and the decision making process, subject to legal and statutory constraints.
  - b. Clear procedures should exist for :
    - i. dependent decision making (decisions subject to ratification, prior notification, or prior approval);
    - ii. the reporting of decisions made by management independently.
5. Appointment and remuneration
  - a. Appointment and remuneration of executives should be determined in accordance with the principles and policies defined by the board and its relevant committee, which should strive to align executives' interest with those of the company and its shareholders as a whole.

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<sup>10</sup> Executives or management here means “executive board” in two-tier board companies or “executive directors” in one-tier board companies.

- b. The elements of the remuneration and shareholdings of the top executives should be meaningfully disclosed at least in the aggregate, together with the material elements of their participation in stock options, pension plans or other similar schemes, as well as severance provisions or payments if in the opinion of the board these exceed customary norms.

## 6. Evaluation and Review

Evaluation and review procedures of management performance should be established and their existence disclosed.

**VIII. Relevant, timely, accurate and understandable disclosure should be made of material information necessary for the proper evaluation of the company's status and situation. Internal controls should provide for the integrity of corporate data. Independent verification and certification of the existence of appropriate controls and the reliability of data, disclosed information in particular, should be obtained to the fullest extent feasible.<sup>11</sup>**

- I. Without prejudice to disclosures advocated elsewhere in these recommendations, information on the company should at least cover:
  - a. its objectives and major business, ethical, stakeholder and community oriented policies;
  - b. its accounts, operational and financial results, historical and current performance and prospects as a going concern, and those of its group where relevant;
  - c. its significant shareholders if known<sup>12</sup> – including cash-flow rights, voting power, diagrams of ownership and control cascades, cross-shareholdings and guarantees, shareholder agreements, special voting rights;

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<sup>11</sup> The EASD Corporate Governance Committee studied initiatives of IASC, IFAC, the European Commission, the European Committee on Auditing, the European bodies of the accounting profession (in particular those of the FEE), the SEC and the FASB, that relate to accounting and auditing in corporate governance. The committee decided to refer to the work of these bodies more explicitly than in other areas, where the committee could not draw on similar European and international standards in the development of its own recommendations.

<sup>12</sup> Significant shareholders should include at least those owning 5 % or more of either cash-flow or voting rights of any class of shares.

- d. its board members and key executives, their characteristics, terms of office, remuneration and shareholdings in the company, other relations with the company where relevant and material, and directorships in other companies mentioning where they are reciprocal;
  - e. material foreseeable risk factors and their monitoring procedures;
  - f. related party transactions;
  - g. governance structures and policies, their implementation and their degree of compliance with these recommendations and other relevant rules and codes of practice;
  - h. internal controls.
2. Disclosed information should be readily accessible at minimal cost, and available simultaneously to all shareholders, taking advantage where legally and practically feasible of electronic data dissemination techniques.
  3. Price-sensitive information may be withheld by the company but only when its best interests so require and on the condition that such information can effectively be kept confidential before being publicly released. If nevertheless price-sensitive information is communicated confidentially to a third party, the latter must be properly informed that that is the case and that it automatically becomes an insider with all the consequences with regard to trading in the financial instruments of the company and its group until the information concerned is publicly released. In recurrent cases in respect of certain shareholders, the company should define and disclose its relevant policies.
  4. Disclosed information should be provided according to recognised high-quality international standards.<sup>13</sup>
  5. Disclosed information should be substantially audited.<sup>14</sup>
  6. The audit should be conducted in accordance with internationally accepted standards.<sup>15</sup>
  7. The external auditors should be independent and free from conflicting interests which, if they exist, must be disclosed.

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<sup>13</sup> IAS, US GAAP or equivalent

<sup>14</sup> See footnote 10

<sup>15</sup> ISAs or equivalent

8. The external auditors' responsibilities towards shareholders are without prejudice to their additional duties of informing the board of their findings with regard to internal controls and other verifications.
9. The external auditors should be present at shareholders meetings to which they report and on request at relevant board and committee meetings.
10. Auditors should be given a hearing by the board at their request.

**IX. Conflicts of interest should be avoided and must, at least, be properly managed and disclosed.**

1. Self-dealing contrary to the company's interest is prohibited.
2. Insider trading is prohibited. A dealing code should be adopted for transactions in the company's and the group's financial instruments by persons considered to be insiders.
3. Where material conflicts of interest occur, they should be disclosed
  - a. at least to the board;
  - b. where significant, to the shareholders (via a shareholder statement).
4. Transactions with related parties should take place “at arm's length”.<sup>16</sup> In any event
  - a. the parties that have a conflict of interest should abstain from voting;
  - b. the transaction should, where sufficiently material, be subject to the approval of the board or, as the case may be, by shareholders.
5. Board members
  - a. A distinction should be made between ongoing and incidental conflicts of interest.

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<sup>16</sup> Related parties would in general include :

1. other upstream, downstream or lateral companies of the same group;
2. directors and officers of the company or its group, their families and the companies they control;
3. a business entity in which such directors or officers have a significant direct or indirect financial interest;
4. another company with common or “interlocking” directors or officers;
5. a company's major blockholder(s), their families, and companies they control.

- b. In both cases, the director concerned should be excluded from voting and, as appropriate, not be present during the decision making process on the relevant item; the quorum, if it exists, should be adjusted accordingly.

6. Executives

- a. Ongoing conflicts of interest must be avoided.
- b. Outside business activities of executives should be reported to and, if significant, approved by the board.

**X. The market for corporate control should be allowed to function in an efficient and transparent manner. Take-over barriers should not shield management, the board and influential shareholders from accountability.**

1. Rules and procedures concerning a projected substantial capital transaction with another entity (such as a sale, acquisition or merger) should be clearly articulated and disclosed, and when they materialise, take place at transparent prices and under fair conditions in respect of all shareholders of the same class.
2. Anti-takeover devices
  - a. Companies should not adopt statutory anti-takeover devices unless they are in the best interest of the company;<sup>17</sup>
  - b. The existence of anti-take-over devices must be disclosed and justified in an appropriate statement to shareholders.
3. Listed companies should not have share transfer restrictions that involve the approval of the board or management.
4. Repurchase of shares, which must be properly disclosed, should not be compulsory, with the exception of residual “squeezeouts”<sup>18</sup> whether requested either by the controlling shareholder or the remaining minority shareholders.

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<sup>17</sup> See Preamble page 2

<sup>18</sup> Situation where one shareholder has gained control over the overwhelming majority of shares, and either he or the remaining shareholders wish respectively to acquire or dispose of the shares still outstanding.

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## CORPORATE GOVERNANCE INITIATIVES

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Within Europe the Cadbury Committee (1992), at the instigation of the London Stock Exchange and the British accounting profession, issued the first set of corporate governance recommendations in the United Kingdom. These were followed by the Greenbury Report (1995), the Hampel Report (1997) and the “Combined Code” that is now part of the London Stock Exchange's listing requirements (1998). In France, two industry associations commissioned the Viénot Report (1995, updated in 1999). In the Netherlands, the Amsterdam Stock Exchange issued the Peters Report (1997). In Spain, the Council of Ministers commissioned the Olivencia Report (1998). In Belgium the Brussels Stock Exchange (1998), its overseer, the Commission for Banking and Finance (1998) and the Federation of Belgian Industry (1998) each issued a report and made recommendations. Also in 1998, Germany passed a Transparency and Control Law (*KonTraG*) and the 3rd Law for the promotion of capital markets (3. *Kapitalmarktförderungsgesetz*). Italy had its Draghi commission and the “Testo Unico” was ratified in February 1998. In 1999, the Italian Stock Exchange issued its own code, in Greece, the Capital Market Commission of the Hellenic Republic issued a set of corporate governance recommendations as did the Securities Market Commission of Portugal.<sup>19</sup>

At the level of the European Union, the European Commission has for quite some time reflected on what it should do about corporate governance. In December 1997 the Internal Market and Financial Affairs Directorate conducted a hearing on the future of European Company Law and corporate governance featured prominently on the agenda, but it concluded on the grounds of subsidiarity that it was not an area for active intervention at the European level. The Commission is further examining the role of the statutory auditor in corporate governance. In June 1998, the Council of Ministers asked the Commission to investigate corporate governance as a potential “cultural barrier” to the creation of a European risk capital market. In May 1999, the European Commission issued an action plan on financial services and announced that it will launch a review of corporate governance practices in the year 2000.

Internationally, a Business Sector Advisory Group headed by Ira Millstein reported to the OECD on “Corporate Governance. Improving Competitiveness and Access to Capital in Global Markets” (1998). To follow up, the OECD ministers gave the OECD Secretariat the mission of developing “global corporate governance standards”. An international Task Force was constituted to do so. The ensuing “Principles of Corporate Governance” were approved in April 1999 by the government delegations and OECD Ministers endorsed them in May 1999. The

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<sup>19</sup> For further references and full text copies, see the European Corporate Governance Network website (<http://www.ecgn.org>).

International Corporate Governance Network advocated adoption of the OECD principles, as amplified by its own, in July 1999. In September 1999, the World Bank and the OECD jointly launched a Global Corporate Governance Forum to promote the dissemination, acceptance and implementation of recognised corporate governance principles worldwide.

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## ACRONYMS

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EASD	EUROPEAN ASSOCIATION OF SECURITIES DEALERS
EASDAQ	EUROPEAN ASSOCIATION OF SECURITIES DEALERS AUTOMATED QUOTATION
ECARES	EUROPEAN CENTRE FOR ADVANCED RESEARCH IN ECONOMICS AND STATISTICS
ECGN	EUROPEAN CORPORATE GOVERNANCE NETWORK
FASB	FINANCIAL ACCOUNTING STANDARDS BOARD (U.S.A.)
FEE	FÉDÉRATION DES EXPERTS COMPTABLES EUROPÉENS
FESCO	FORUM OF EUROPEAN SECURITIES COMMISSIONS
IAPC	INTERNATIONAL AUDITING PRACTICES COMMITTEE
IAPSS	INTERNATIONAL AUDITING PRACTICE STATEMENTS
IASC	INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE
ICGN	INTERNATIONAL CORPORATE GOVERNANCE NETWORK
IFAC	INTERNATIONAL FEDERATION OF ACCOUNTANTS
ISAs	INTERNATIONAL STANDARDS ON AUDITING
IOSCO	INTERNATIONAL ORGANISATION OF SECURITIES COMMISSIONS
NASD	NATIONAL ASSOCIATION OF SECURITIES DEALERS (U.S.A.)
NASDAQ	NATIONAL ASSOCIATION OF SECURITIES DEALERS AUTOMATED QUOTATION (U.S.A.)
NYSE	NEW YORK STOCK EXCHANGE
OECD	ORGANISATION OF ECONOMIC CO-OPERATION AND DEVELOPMENT

SEC            SECURITIES AND EXCHANGE COMMISSION (U.S.A.)

US GAAP      GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (U.S.A.)