EUMEDION
CORPORATE GOVERNANCE FORUM

Attention of Mr. Michel Barnier
Commissioner for Internal Market and Services
European Commission
Office: C107 07/42
Wetstraat 130
B-1049 Brussels
BELGIUM

Amsterdam, 25 February 2013

Our ref: B13.07

Subject: Eumedion position institutional investor's position on reaction plan on European company law and corporate governance

Dear Commissioner,

We write to you with reference to the Action Plan on European company law and corporate governance, issued on 12 December 2012.[1] Eumedion is the dedicated representative of the interests of 69 long term institutional investors – all with a long term investor horizon – and aims to promote good corporate governance and sustainability in Dutch and European listed companies. Together they have more than € 1 trillion assets under management. They are capital providers to listed companies across the European Union, from equity to covered bonds.

Eumedion is very grateful for the European Commission's considerable efforts to create a more effective European framework in the areas of corporate governance and company law in order to support European companies' growth and their competitiveness. We have been a long time proponent of good and accountable corporate governance, which serves to protect and preserve assets and is an important driver in achieving long term and sustainable investment returns.

[1] Communication from the European Commission of 12 December 2012, ' Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies', COM (2012) 740 final.

The Eumedion Best Practices on Engaged Share-Ownership[2] - also mentioned in the Action Plan - provide the framework by which our participants execute their engagement and governance responsibilities.

We support the Commission's view that good corporate governance is first and foremost the responsibility of the company concerned, and rules at EU and national level are in place to ensure that certain standards are respected. Also, we endorse the approach that the EU corporate governance framework should be a combination of legislation and soft law, i.e. national corporate governance codes applied on a (statutory) 'comply or explain' basis.

Below you will find our views on some of the sixteen action points announced in the Action Plan. We hope you will take these thoughts into account when developing legislative and soft law proposals to implement the Action Plan action points.

1. The importance of shareholder engagement

Eumedion endorses the Commission's approach to strengthen effective shareholder engagement as a cornerstone in listed companies' governance structure. Although boards of directors are primarily responsible for the governance of their companies, institutional shareholders have their own interest and commitment to promote good corporate governance practices and risk mitigation. Fit for purpose shareholder engagement could support boards in better management of the company's affairs and may lead to greater investor confidence in the strategy of a company and in its implementation. Engaged share-ownership is an effective instrument for institutional investors to serve the interests of their clients as ultimate beneficiaries.

However, shareholders' ability to monitor investee companies and ensuring that the governance is appropriate, depends on (i) effective disclosures, (ii) the attitude and responsiveness of boards of the listed companies involved and (iii) meaningful rights that can be enforced in practice.

In this respect, we are deeply concerned about the lack of progress on the exercise of voting rights through cross-border holding chains. While IT services and infrastructure for cross border voting have significantly improved over the years, there is still no uniform EU framework that governs issues that are of crucial importance for exercising voting rights cross-border. Nine years after the European Commission set out a roadmap for action to enhance the safety and efficiency of post-trading arrangements, we are still in the process of weighing regulatory options. We believe it is time for the European Commission, Member States and regulators to 'bite the bullet' and finalise the legislation needed shortly.

Effective abilities to vote and the execution of other rights across the board will greatly enhance institutional investors' ability and appetite to act as proper stewards as such is in line with the corporate governance reform actions of the Commission.

[2] http://www.eumedion.nl/en/public/knowledgenetwork/best-practices/best_practices-engaged-share-ownership.pdf

Given their fiduciary duty – the responsibility to act on behalf of their (beneficial) clients – it may not be realistic to expect *all* institutional investors to engage actively with all investee companies, albeit Eumedion's preference for engaged ownership. Investors are free to choose a (partly) passive investment model. Also, meaningful engagement between companies and shareholders to improve performance can be a resource and time intensive process for both parties. But we think it is realistic to convince a substantial proportion of the investors to act as engaged, long term oriented, shareholders, at least for their major holdings in a meaningful manner. The Commission's planned actions will certainly help to this goal.

We have already witnessed a tendency towards more engagement, encouraged by stewardship codes, principles, best practices and guidelines, developed e.g. by the United Nations ('Principles for Responsible Investing'), in the United Kingdom, the Netherlands, South Africa, Switzerland, India and by the European Fund and Asset Management Association (EFAMA). The UK Stewardship Code has gained an impressive number of signatories in just two years time. Eumedion's Best Practices on Engaged Share-Ownership are well applied and supported by the its participants.[3] Many of them have disclosed their engagement policies and practices on their websites. Furthermore, the International Corporate Governance Network (hereafter ICGN) has issued a model for contract terms between asset owners and their fund managers to align the respective interests more fully.[4]

In addition, large Dutch pension funds such as PME are considering establishing a more concentrated portfolio.[5] SPF Beheer, the asset manager of the Dutch Railway Pension Fund and the Dutch Public Transport Pension Fund, already changed to a more concentrated portfolio with material and committed shareholdings a few years ago. And in 2008, a Dutch asset manager launched a new portfolio to combine 'ESG' and active ownership implementation in practice – the Responsible Equity Portfolio (REP), a dedicated equity portfolio with a long-term investment horizon and characterised by high concentration (15-20 holdings).[6] REP began investing in January 2009 with an initial mandate of €1 billion. Since then, it has grown to €3 billion in committed capital and has invested approximately €2.4 billion as of January 2012.

2. Strengthening transparency for institutional investors

We generally support the Commission's approach to improve the disclosure of voting and engagement policies by institutional investors. Disclosure of voting and engagement policies serves both clients who can see what engagement approach is being undertaken as well as the listed companies involved who can anticipate the sort of dialogue they would expect to have. Requiring institutional investors to also disclose their voting records could constitute evidence that the publicly disclosed policy was being followed. At the same time, the more disclosure required around each vote, the higher the compliance cost are.

[3] http://www.eumedion.nl/nl/public/kennisbank/best-practices/monitoring_rapport_eumedion_best_practices_2012.pdf
[4] http://www.icgn.org/files/icgn_main/pdfs/agm_reports/2011/item_9.2_icgn_model_mandate_initiative.pdf.
[5] http://www.eumedion.nl/en/news/report_from_the_eumedion_conference___know_more_of_less_companies_
[6] A. van der Velden and O. van Buul, "Really Investing for the Long-Term: A Case Study", *Rotman International Journal of Pension Management*, Volume 5, Issue 1, 2012, p. 50-57 (http://utpjournals.metapress.com/content/e20w445p177uh325/fulltext.pdf).

Some voting records can only be understood in the context of earlier engagement. Whereas clients of that institutional investor are entitled to know the context, the effectiveness of engagement could be seriously reduced if the institution investor is required to immediately disclose to the broader public.

Voting disclosure is currently recommended in the Dutch corporate governance code, the Eumedion Best Practices on Engaged Share-Ownership and in the UK Stewardship Code on a comply or explain basis. We would strongly encourage the European Commission to consider the possibility of establishing these provisions of voting and engagement policies on a comply or explain basis at EU level. We prefer a requirement for institutional investors that corresponds to the requirement for listed companies: article 46a of Directive 78/660/EC[7] prescribes that EU listed companies make a reference to: (i) the corporate governance code to which the company is subject, and/or (ii) the corporate governance code which the company may have voluntarily decided to apply, and/or (iii) all relevant information about the corporate governance practices applied beyond the requirements under national law.

We would be cautious of prescriptive rules at EU level and heavy scrutiny by public supervisory authorities, as this creates potentially complicated requirements with regard to scope and format, and could involve compliance costs which outweigh any potential benefits. If regulation on voting disclosure were to be established, a substantial group of investors would probably opt for a box ticking approach to voting and engagement and increasingly rely on proxy advisors' services and recommendations. Such a development would have negative effects to the engaged and responsible ownership strategies of many institutional investors rather than strengthening it.

Dutch experience shows that inserting some transparency requirements for institutional investors in a (soft law) code can indeed contribute to shareholder engagement and investor awareness. Ever since the introduction of these requirements in 2004, we have seen a rather spectacular increase in the participation rate at the shareholders' meetings of the largest Dutch listed companies: from approximately 33% in 2003 to 64% in 2012. In the context of these requirements, Eumedion was established, resulting in more collective engagement by institutional investors with Dutch listed companies. This has also been recognised by the Dutch Corporate Governance Code Monitoring Committee.
In the 2012 monitoring report, the Committee concludes that in the Netherlands both shareholders and companies are investing in constructive, mutual relationships.[8]

3. Better shareholder oversight of the remuneration policy

We fully support the Commission's initiative to make EU listed companies remuneration policies subject to a shareholder vote. We consider providing shareholders with a vote on remuneration is a baseline requirement to enhance the accountability of the remuneration structures and the directors

[7] Fourth Council Directive of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies (78/660/EEC) (OJ L 222, 14 August 1978, p. 11).
[8] http://www.mccg.nl/download/?id=2111.

who oversee them. A binding nature of the vote will inevitably mean that a greater number of European listed companies will have to give serious consideration to their executive remuneration policies and structures and start engaging with their shareholders in the early stages of the process. A binding vote on remuneration policy was introduced in Dutch Company Law in 2004 and since then we have witnessed the following effects:

A. More 'up front' dialogue with shareholders

Especially after the 2008 General Meeting of Royal Philips Electronics rejected the proposal to change the long term incentive plan, there is a growing willingness on the part of Dutch listed companies to actually enter into a dialogue with shareholders in advance of the shareholders' meeting, in order to provide shareholders with explanations of possible proposals to change the remuneration policy at an early stage, to learn of the initial views of the shareholders and to take these into account in the final proposal submitted to the shareholders' meeting. The threat of voting down remuneration proposals looks to be an uncomfortable burden for many listed companies and their supervisory board members.

The quality of the dialogue varies, however. A small number of companies involve their shareholders at a very early stage in order to find out what their specific issues are with regard to the existing company's remuneration policy, and subsequently return several times to present draft proposals for amendment to the policy and to hear the comments on these before the definitive proposal is finally presented at the shareholders' meeting. In contrast, however, there are also a number of companies that run through a complicated proposal for an amendment to the remuneration policy at breakneck speed in a very short session, following which shareholders are allowed a very short time to respond to the proposal, without the required documentation being left behind for further study. In this manner, dialogue becomes more of a formality or simple box-ticking in order to be able to state in the definitive proposal that the proposal is the result of an intensive consultation process with the most important shareholders. There is scarcely any question of a fruitful dialogue in such cases. The quality of the dialogue is largely determined by the length of the period within which shareholders can state their opinions on (draft) proposals and prompt commencement of consultation can prevent unnecessary polarisation shortly before or during a shareholders' meeting.

None of this detracts from the fact, however, that a board must always make its own decisions on the final proposal presented to the shareholders' meeting. After all, boards should also weigh up other interests when considering a proposal than the shareholders' interest alone. Boards also bear ultimate responsibility for the proposal that is presented.

B. Change in composition of remuneration

Research[9] suggests that the composition changed significantly after the introduction of the binding say on pay vote, with more focus on variable compensation (and therefore a stronger link between pay and performance). The growth rate of cash compensation was significantly lower after the introduction of the binding say on pay vote.

[9] S. Halters, *Say-on-pay in The Netherlands, an extensive analysis of the effects,* January 2011 (Master Thesis).

This is partially influenced by the economic conditions, but it also shows that the remuneration policies are more oriented at long term variable pay. Moreover, stock based compensation became more popular than stock options.

C. *Correlation between executive total cash remuneration and company performance improved*
According to a study of the Groningen University, conducted on behalf of the Dutch Corporate Governance Code Monitoring Committee, in November 2007 "The relation between the remuneration of executives of listed companies and the performance of these companies" (study only in Dutch), there is a positive correlation in the Netherlands between shareholder value and the level of the overall remuneration. The cash bonus reflects a positive correlation with turnover and profitability. The award of shares and stock options is closely related to the creation of (relative) shareholder value. The study was, however, constrained by three limitations:
• The study looked at relationships between remuneration and four separate performance criteria. Combinations of different criteria in a single remuneration package – as often happens in practice – were not included.
• The study focused only on the question of whether performance influences remuneration. The question as to the reverse relationship, namely the influence of remuneration on performance, cannot be answered on the basis of this study.
• It is unclear how much time elapses between performance and remuneration. In the study, evidence was found for both simultaneous effects and for the effects of performance on remuneration in the following year.

In light of these positive effects of a binding say on pay vote in the Netherlands, we would support the introduction of a binding shareholder vote on executive remuneration policies at all EU listed companies. At the same time, we believe it is important to emphasise the importance of long-term thinking about remuneration. An annual vote on the policy may encourage short term visions on the policy.

Therefore, the binding vote on remuneration policy should only be invoked in certain circumstances:

- When there are material changes to the policy; or
- After a certain period of time, say every four years.

We support the European Commission in introducing an *annual*, retrospective vote (at least advisory) on the remuneration report so that shareholders are in a position to adequately hold the board to account on the execution and results of the (by the AGM adopted) remuneration policy. In the Netherlands we experience large differences in the quality of remuneration reports. Many Dutch listed companies, for instance, provide no clarification on the amount of the short-term bonus paid (by means of the scores on each performance measure for example) and sometimes refuse to provide information on the severance packages agreed on with executives when these differ from the relevant provision in the Dutch Corporate Governance Code.

Holding an annual vote on the remuneration report, as is done in the United Kingdom, could therefore possibly also encourage companies to prepare more transparent remuneration reports.

With regard to substance of the remuneration report, we would be in favour of legislation at EU level that requires that each EU listed company at least:

- discloses the individual remuneration packages of executives and directors;
- shows how its remuneration policy relates to performance;
- shows how its remuneration policy is linked to the delivery of the company's strategic objectives and the management of risk;
- discloses the potential outcomes of the remuneration policy.

4. Better shareholder oversight of related party transactions

We welcome the Commission's announced proposal to improve shareholders' control over related party transactions. Related party transactions are of enormously importance to a company and its shareholders and it is of equal importance that the interests of minority shareholders are adequately protected, in particular when ownership of the listed company is concentrated.

The nature of related party relationships and transactions may give rise to higher risks of actual or perceived conflicts of interest. A related party could be involved in a significant transaction outside the company's normal course of business not only by directly influencing the transaction through being a party to the transaction, but also by indirectly influencing it through an intermediary. To reduce these risks an interested related party should at least notify the chairman of the board of a potential conflict of interest. Also, decisions to enter into related party transactions outside the entity's normal course of business, needs the approval of the supervisory board or of the non-executive board members.

Moreover, it is our strong believe that related party transactions above a certain level (for instance 1% of the assets, as proposed by the European Corporate Governance Forum) must be put to a shareholder vote, and that only those shareholders which are not related parties should be able to vote upon them. This is the only way minority shareholder interests are properly protected in such circumstances. Hence, we welcome the Commission considering a legislative response to this in the form of a Directive or a Regulation. The 2011 Statement of the European Corporate Governance Forum on Related Party Transactions for Listed Entities[10] presents the Commission a proper template for that piece of legislation.

5. Clarification of the relationship between investor corporation on corporate governance issues and the 'acting in concert' principle.

We support the Commission's approach to develop guidance on the relationship between investor cooperation on governance and 'acting in concert'. It appears that several EU rules may hinder effective shareholder cooperation and collective engagement. Under the 'acting in concert' rules in

[10] http://ec.europa.eu/internal_market/company/docs/ecgforum/ecgf_related_party_transactions_en.pdf.

the Take Over Bids Directive and Transparency Directive it is far from clear whether certain forms of cooperation between shareholders may qualify as an acting in concert event. As a result shareholders are reluctant to cooperate even when teaming up would benefit shareholders' effectiveness regarding engagement with listed companies.

We would urge the Commission and/or the European Securities and Markets Authority (ESMA) to make clear that acting in concert is only a problem when there is a collective effort to change control and/or corporate strategy, and that collective engagement by investors on 'routine matters' like remuneration or the need to strengthen the existing management are not regarded as acting in concert. Given the dispersed shareholding nature of many listed companies and the resource allocation challenges institutional investors are faced with, it is almost inevitable that more engagement will need to be established collectively.

On 20 November 2009, the Netherlands Authority for the Financial Markets (AFM) published guidelines for submitting a (collective) notification of a substantial holding[11]. The AFM made it clear that there is no question of acting in concert when the cooperation relates to the preparation of one single general meeting and/or regular points on the agenda for the general meeting. According to the AFM, acting in concert can only exist in the event that institutional investors cooperate for more than one general meeting, in order to change the company's strategy and/or to propose joint candidates for the board. Eumedion would welcome a similar approach at EU level and would therefore support new initiatives for a clearer and more uniform regime in this respect.

6. Disclosures of board diversity and management of non-financial risks

We generally support the Commission's policy to strengthen disclosure requirements regarding board diversity policy and risk management through an amendment of the Accounting Directive (78/660/EC).

Diversity

Listed companies should be required to disclose their diversity policy as well as report on its implementation. This diversity policy should apply to boards and also to the rest of the workforce. We would like to see a holistic approach developed when requiring diversity policies which include professionalism, nationality and gender. Diversity in a broad sense can help to reduce 'the old boys network', 'group think' and may generate new ideas, thereby preserving a high quality board. A diversity policy could in our view best be integrated in the company's general policies on providing and maintaining the quality of the board and of the employees. It is the individual company board's responsibility to make sure that they have and keep the right balance between independence, skills and diversity. Most companies have a nominations committee. It would seem appropriate for the nominations committee to have the functional responsibility for diversity and that they report to shareholders and other stakeholders how they are performing in this respect. In our opinion, there is some scope for improving the quality of disclosures by nomination committees.

[11] http://www.afm.nl/marktpartijen/upl_documents/acting_in_concert_eng.pdf.

Management of non financial risks

Listed companies' profits are often a result of risk-taking activities. Risk management is not about eliminating risk but about ensuring optimal risk-taking without endangering the viability of the listed companies. The financial crisis has made clear that a lack of risk insight and failure of risk management systems can have dramatic consequences. Important risk issues were sometimes insufficiently understood and discussed at board level.

We believe that risk management needs to have a higher profile within listed companies in the EU. This should start at the top and boards should closely oversee the risk management function of their organisations. The decisions taken in relation to the company's "risk appetite" should be disclosed to shareholders, but only those which are genuinely material. In fact, more disclosure is not always better disclosure and a focus on the key material risks is vital.

Disclosure is also essential as risk and risk oversight must be understood broadly, not only within the listed companies but also among shareholders, as referred to in the ICGN Corporate Risk Oversight Guidelines 2010. Investors need to consider financial and non-financial risks of which the effects are manageable within the organisation's sphere of influence. Those include, but are not limited to, market risks, operational risks, financial reporting and compliance risks, but also material risks on environmental, social, governance and reputational risks.

7. Shareholders identification

In general we support the proposal to introduce a system which enables issuers to identify who ultimately hold their shares. This will facilitate the transparency and integrity of the voting process and at the same time encourage the dialogue between the company and its shareholders. In order for a shareholder disclosure system to work effectively the following key conditions need to be fulfilled:

- Not only issuers but also shareholders themselves should be able to take notice of (other) shareholders' identities (level playing field of information);
- Issuers and custodians should be obliged to facilitate the exchange of information between identified shareholders;
- The system should not impose unreasonable duties and costs on shareholders and/or issuers;
- Use of the system for voting process' purposes only (i.e. no advertisement);
- Only the identity and not the specific interests in investee companies should be disclosed upon issuers' request. Transparency of specific interests may imply disclosure of commercial sensitive information on the investment strategy which can infringe competition between investors;
- The number of identification requests should be limited.

8. Regulating proxy advisors

We understand the Commission's approach to consider improving the transparency and conflicts of interests frameworks regarding proxy advisors. In our response to last year's consultation by ESMA[12], we noted that proxy advisors have the obligation to meet the interests of their clients and their beneficial owners and ensure that their advices are aligned with these interests. Enhanced transparency could contribute to proxy advisor's quality and accountability. The clients of the proxy advisors and the wider public should be enabled to get more insight into the 'checks and balances' of proxy advisors.

However, we are not convinced that there is sufficient supporting evidence for regulatory interference in the small and vulnerable proxy advisory market. If it is decided to take EU policy action, we have a strong preference for non-binding guidelines (Code of Conduct) or recommendations to promote proxy voting advisors' quality and integrity, and to be adopted by the European Commission and/or ESMA, as also recommended by ESMA.[13] Non-binding or quasi-binding standards, for instance by means of a code of conduct, best reflect that institutional investors are primarily responsible to hold proxy voting agencies to account and also offer flexibility to proxy advisors to continue to use their own codes of conducts. Developing guidance by ESMA would be a proper way to promote the development of such EU-wide and non-binding standards which aim to raise proxy advisors' transparency and mitigate their potential conflicts of interests.

While it is important that the proxy agencies offer a high standard of advice, they cannot be held responsible for the way the advice is used by their clients. Therefore, it is also important that issuers do not seek to engage with proxy agencies as an alternative to talking to their shareholders.

We would be very happy to discuss these ideas further with you and your officials and look forward to a continued contribution to the realization of the final measures. Our contact person is Mr. Wouter Kuijpers, T. +31 (0)20 708 5882, E. wouter.kuijpers@eumedion.nl.

Yours sincerely,

Rients Abma
Executive Director Eumedion

c.c.: Mr. Jeroen Hooijer (by e-mail)

[12] http://www.eumedion.nl/en/public/knowledgenetwork/consultations/2012-06_esma-consultatie_stemadviesbureaus.pdf.
[13] http://www.esma.europa.eu/news/ESMA-recommends-EU-Code-Conduct-proxy-advisor-industry?t=326&o=home.