

# Corporate Governance Committee

## **The public consultation: comments received and main changes made**

### 1 Introduction

The draft Code was published on 18 June 2004 and was open for public consultation until 15 September 2004.

The final Code is the fruit of the public consultation held on the draft Code and of recent European initiatives in the field of corporate governance.

#### ***Amending the form of the Code***

##### **The public debate ...**

With more than 300 pages of comments received, the public consultation held on the draft Code was clearly a success. This consultation also led to a public debate on corporate governance, which was conducted in the press, in different fora and among different market players.

In that context, the Chairman of the Committee was invited to a hearing at the Parliament where a constructive dialogue on corporate governance issues took place.

##### **... led to important changes to the form of the Code ...**

The results of the consultation and the public debate on corporate governance stressed that the Code should give clear guidance on what the main principles of corporate governance are and on what the “comply or explain” principle would imply for the companies

This led the Committee to structure the Code around nine key principles, which form the provisions, describing how to apply the principles, and by guidelines, giving additional guidance for the implementation of the provisions.

##### **... and the text of the provisions.**

The text of the provisions is generally based on the text of the principles and provisions in the draft Code. However, comments and suggestions made during the consultation were carefully considered and have led to a number of changes. Furthermore, the Committee stayed abreast of the latest European developments in corporate governance. It is indeed undeniable that the European Commission has accelerated its efforts in this area over the last months.

Examples of recent developments include:

- the European Commission's Recommendation 'on the role of non-executive or supervisory directors and on the committees of the supervisory board',
- the European Commission's Recommendation 'on fostering an appropriate regime for the remuneration of directors of listed companies' and
- the European Commission's consultation document on 'fostering an appropriate regime for shareholders' rights'.

Some parts of the Code are now very clearly influenced by these texts, for example, the provisions on the criteria of independence of directors, the remuneration of directors and executives or the company's relationship with shareholders.

Below is a summary of the most significant issues raised during the consultation and the amendments made to the text.

## 2 Main issues and amendments

### 2.1 The 'comply or explain' approach

Although a majority of those commenting supported the flexible approach proposed in the Code, many wished for more emphasis on the ability to explain and clearer guidance on how to apply the Code. There was also a fear that the obligation to comply or explain was too wide in scope and as a result, its implementation would be very burdensome for companies. Most importantly, commentators underlined that the draft text contained too many provisions of a mainly qualitative nature, the compliance with which would be very difficult to assess practically.

For these reasons, the Committee reorganised the text of the Code and defined three categories of recommendations: principles, provisions and guidelines. Principles are of a general nature. Companies must follow them. Provisions are recommendations on how to implement the principles. If a company chooses not to comply with a provision, it must explain why. For guidelines, the obligation to comply or explain does not apply because of their predominantly qualitative nature. The guidelines are there to help companies implement the principles and provisions of the Code but will not need to be assessed in terms of compliance.

The Committee is of the opinion that this distinction between (key) principles, provisions and guidelines will facilitate the implementation of the Code as well as the assessment of the company's actual corporate governance.

### 2.2 Entry into force

The developments in the draft Code on entry into force were considered unclear by many who commented. For the sake of clarity, it has been redrafted as follows:

- The Code enters into force on 1 January 2005.
- At the general meeting held in 2005, corporate governance should be an item on the agenda for information and consideration.
- Where possible, a statement on corporate governance should already be included in the annual report for the year 2004, published in 2005.

- As from 1 January 2006, listed companies should have made public a Corporate Governance Charter, outlining their corporate governance structure and policies.
- In the annual report for the year 2005, published in 2006, listed companies will be expected to devote a specific chapter to corporate governance, describing their governance practices during that year and including explanations, where applicable, on deviations from the Code.

### **2.3 The Board and Board's members**

Responding to widespread demand, the collegial character of the board has been further asserted. The board's role has been slightly restated so as to meet suggestions, relating, in particular, to the determination of matters reserved for the executive management and to the board's duty vis-à-vis legal compliance.

The principle relating to the balanced composition of the board has been translated into more precise provisions to eliminate speculation as to what a balanced board might consist of (not a mathematical calculation: one third independent non-executive, one third non-executive and one third executive directors as some suggested).

On the definition of independence, the members of the Committee have decided to refer companies to the criteria laid down in the Commission's Recommendation 'on the role of non-executive or supervisory directors and on the committees of the supervisory board', without prejudice to the situations in which article 524 must be applied under Belgian company law. As in the Commission's Recommendation, it will remain the board's prerogative to decide ultimately whether a director should be deemed independent despite non-compliance with one or several of the Code's listed criteria, but it must then justify its decision.

In view of recent developments and the public debate on corporate governance that has taken place in recent months, the Committee considered it important that one of the key-principles stress the requirement for directors to demonstrate integrity and commitment. Other important changes include the express reference to non-executive directors' right to independent expert advice and a limitation on the number of directorships allowed (five in listed companies).

The Committee also decided to add a specific provision on directors' duty of discretion (notwithstanding the existing case law on the subject) and to rephrase the provisions on conflicts of interest so as to specifically include the chairman.

For transactions in company stock, some of those who commented asked for more detailed provisions, in particular with regard to matters such as the timing of the disclosure and the inclusion of family-related transactions. On this matter, the Committee decided to align its position with Directive 2003/6/EC, which will be soon implemented in Belgium. In that sense, the current provisions of the Code must be seen as a minimum requirement, to be supplemented or replaced by the new provisions under Belgian law once they are in force.

On appointment procedures, provisions have been added to involve the nomination committee if the proposal for appointment comes from a shareholder.

Many comments were expressed regarding the organisation of meetings between the non-executive directors in the absence of the CEO or the executive directors. The Committee agrees with the majority of comments expressed that those meetings should not be regarded as board meetings, hence the provisions of the Code relating to the board do not apply to those 'sui generis' meetings.

The provisions on the length of directorships and their effect on the possible loss of independence have been strengthened; the recommended duration of the mandate is now reduced to four years. The draft Code's provision subjecting a non-executive director's mandate above 12 years to rigorous review has now been abandoned. On the loss of independence, the relevant European Commission's recommendation on independence will apply, i.e. loss of independence after 12 years, bearing in mind that the board may consider a director independent after three terms subject to the obligation to explain its reasons for doing so ('comply or explain').

The requirements for a formal and annual individual evaluation have been deleted, in line with the opinion expressed that an annual evaluation would quickly lead to 'box-ticking evaluation' and that the disclosure of a formal procedure would create unnecessary formalism. Instead, an individual evaluation will be conducted when re-election is being considered.

On remuneration, there has been a mixed reaction to the provision according to which non-executive directors should only be entitled to fixed remuneration, some approving, others arguing in favour of partial compensation in shares. The Committee believes that the payment to non-executive directors of performance-related remuneration, such as shares, share options or 'tantièmes', does not represent best practice and should not be encouraged.

## **2.4 Board committees**

The composition of the board committees has been the focus of much attention and comment. Following publication of the Commission's Recommendation on the role of non-executive directors referred to above, the Committee has decided to recommend the same composition as that put forward by the EU Commission for each of the three committees: audit, nomination, and remuneration. As a result, the audit committee should be composed exclusively of non-executive directors as originally provided but, as requested by a majority of those commenting, only a majority of them should be independent.

As far as reporting from the committees to the board is concerned, the opinion was expressed that it should not include a full detailed reporting on the deliberations themselves. The Committee takes the position that, notwithstanding the importance of the Committees' work, the decision-making remains within the collegial responsibility of the Board. Each committee should therefore report to the board after each meeting on its findings and its recommendations.

The provision prohibiting the chairman from being a member of the audit committee has also been deleted (as the EU Recommendation referred to above did not include such a provision) but the recommendation that the chairman of the board should not chair the audit committee remains.

The provisions on the role and operation of the audit committee have been redrafted so as to include most of the guidelines in the EU Commission's text. The provision providing for the audit committee's review of occasional information has been deleted. Indeed, according to Article 6, §1 of the Royal Decree of 31 March 2003 on the obligations of issuers of financial instruments admitted to trading on a Belgian regulated market, occasional information must be disclosed forthwith. Such an immediate disclosure is impossible, in practical terms, if the company must convene an audit committee meeting to review the information before publication.

The provisions on the operation of the nomination and remuneration committees have also been supplemented by the EU Commission's guidelines on the involvement of the CEO in the nomination and remuneration of members of management.

## **2.5 Management**

The term 'senior management' in the draft seemed too broad in its scope and has been replaced with 'executive management'.

Some expressed the wish to see some form of special delegation organised in the Code as a supplement to the already existing provisions in article 524 bis of the Code on Companies. However, the Committee has not judged it necessary or useful to expand on the subject given the availability of Belgian civil law provisions for delegating specific tasks in the form of 'mandats spéciaux'. The obligation in the draft to disclose any such mandate has been removed from the disclosure requirements so as to avoid possible confusion between 'internal' and 'external' powers.

## **2.6 Remuneration**

Many comments were also addressed to the Committee with a view to either limiting or extending the scope of the provisions concerning remuneration in the draft code. A recent case of bad governance and lack of integrity led to an important public debate, giving the opportunity for the Senate to consider the adoption of remuneration disclosure requirements.

In its deliberation on this topic, the Committee paid great attention to the EU Recommendation referred to above (Recommendation *'on fostering an appropriate regime for the remuneration of directors of listed companies'*).

After much consideration, the Committee decided to maintain its original recommendations, subject to the addition of some provisions providing for the establishment and disclosure of a remuneration policy – in particular for the Executive Managers, whether they are members of the Board or not. The Committee regards the existence and disclosure of such a policy as an essential element on which to assess the remuneration practice of a company. As far as actual remuneration is concerned, the Code provides a high level of transparency, in particular for the CEO and the other executive managers, for whom it is required to disclose the components of the remuneration and its consistency with the remuneration policy.

## **2.7 Shareholders**

Following the numerous responses to the third part of the draft section on 'shareholders', several changes were made to encourage communication between companies and their shareholders and to strengthen and better define shareholders' rights and duties. The changes were drafted with the EU Commission's recent consultation document on *'fostering an appropriate regime for shareholders' rights'* in mind.

Special attention was focused on the communication of information to shareholders both before and after general meetings and on underlining shareholders' equal rights of access in that respect. The Code encourages the use of electronic means for such communication, although it is also recognised that many (technical and other) problems still need to be overcome.

The Code also aims to encourage participation at the general meeting. An important strengthening of shareholders' rights is the lowering to 5% of the level of shareholding imposed by companies for tabling resolutions and placing additional items on the agenda of the general meeting. This should encourage shareholders to actively use their rights. Furthermore, investors should be informed, as soon as possible after the shareholders' meeting, about the decision-making process, the results of votes and minutes of the meetings. . .

## **2.8 Monitoring and follow-up of the Code**

Some commentators asked questions about enforcement, monitoring and follow up of the Code. The Committee discussed these issues in detail and clarified its position as follows.

In line with the EU Action Plan, the Government must designate a national corporate governance code. The Committee recommends that Belgian authorities consider designating the Code drafted by the Committee as the Belgian code of reference.

Regarding monitoring, the Committee believes that in the Belgian context, where listed companies are often controlled by one or two major shareholders, one cannot rely on market monitoring alone.

Therefore, the Committee has opted for a combined monitoring system, relying on the company's board, its shareholders and the Banking, Finance and Insurance Commission (BFIC). This monitoring system could be supplemented by other mechanisms.

Initial monitoring should occur at board level: indeed it will be the board's responsibility to see to the accuracy and completeness of the Corporate Governance Charter and Corporate Governance Chapter of the annual report.

Shareholders should also play an important role in monitoring compliance with the Code. Given the 'comply or explain' approach in the Code, they will need to carefully consider all factors brought to their attention in the Corporate Governance Charter and in the relevant chapter of the annual report. Departure from the Code may be justified and should [not] automatically lead to a unfavourable view of the company's corporate governance practices. In that context, it will be essential for shareholders to enter into a dialogue with the board if they do not accept the company's justification for a deviation from the Code, bearing in mind such matters as the company's size, and the complexity of the risks and challenges it faces.

Furthermore, as stated in the draft Code, the BFIC will contribute to monitoring of the Code, acting within its mission of supervision of the periodic and ongoing information obligations of listed companies as laid down in the Law of 2 August 2002. The public consultation did not bring suggestions for changes on this matter.

Agreeing with many commentators, the Committee considers that what constitutes good corporate governance will evolve with changing business circumstances and international financial markets requirements. It will therefore be important to ensure a regular review of corporate governance practices and the adaptation of the recommendations. This will require the setting up of an appropriate mechanism.

At the invitation of Parliament, the Committee will continue to reflect, with the Government, on how to organise the follow-up of the Code. The Committee will remain active in the meantime.■