



PRACTICAL RULES FOR HIGH-QUALITY EXPLANATIONS

Reason for drafting practical rules

The 2009 Belgian Code on Corporate Governance has become the benchmark for Belgian listed companies since the adoption of the Royal Decree on 6 June 2010. In addition, the ‘comply or explain’ principle has been legally recognised. Consequently, companies must clearly indicate which parts of the 2009 Code they depart from and specify the reasons for such departure.

Objective of the Corporate Governance Committee

There are still serious doubts about the real meaning of high-quality explanations. This also raises questions about the Code’s application. Accordingly, the Committee is intent on providing companies with a practical tool, both to ensure more transparent compliance with the 2009 Code and to improve the quality of the given explanations.

Preliminary study

The Committee commissioned law firm Linklaters to conduct a study to report on how the ‘comply or explain’ principle was being implemented. A copy of this study is attached in the annex to this document.

The study analysed the situation in the various European countries and concluded by making a string of general observations. Firstly, there was a general consensus that the quality of explanations needs to be improved. Furthermore, there does not seem to exist a set of widely applicable guidelines which sets out what high-quality explanations actually entail.

The study attempted to extract certain criteria for high-quality explanations from the analyses of the European countries under scrutiny. In general, the United Kingdom and Sweden ‘explain’ better than other countries, because their governance codes contain stricter guidelines on high-quality explanations.

- The United Kingdom specifies two quality criteria with regard to explanations: firstly, actual practice must be consistent with the principle to which the particular provision relates and secondly, it must contribute to good governance.

- The Swedish definition of what an ‘explain’ involves is even broader. There, the company is to state clearly which Code rules it has not complied with, explain the reasons for each case of noncompliance and describe the solution it has adopted instead.

Europe also prefers the ‘comply or explain’ model to a regulatory approach, citing shareholders’ responsibility in particular, whilst stressing the role of independent directors in governance models with a reference shareholder.

The 2009¹ study by RiskMetrics revealed that the quality of explanations were not always satisfactory, but that the ‘comply or explain’ principle enjoyed considerable support from regulators, investors and companies.

In April 2011, the European Commission also expressed some reservations in the Green Paper on the EU corporate governance framework: *“So some adjustments appear necessary to improve the application of the corporate governance codes. The solutions should not alter the fundamentals of the ‘comply or explain’ approach but contribute to its effective functioning by improving the informative quality of the reports.”*

The responses received² in this connection did not favour a regulatory approach. Most respondents found that better quality of the explanations should be provided by companies. As for the level at which this issue needed to be addressed, it should be left to the Member States to deal with the matter, and the market should have its saying on the assessment of the implementation of the “comply or explain” principle.

Practical rules for better explanations – February 2012

Too many listed companies still make do with very formal and superficial explanations. The Committee would like to give companies a set of practical rules enabling them to provide high-quality explanations. In this connection, the Committee’s main focus is on how explanations are presented, prepared and assessed by companies and on what constitutes high-quality explanations.

Thanks to these practical rules, the Committee hopes to maintain a balance between the consideration of these practical rules and the flexible application by companies.

¹ Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States, http://ec.europa.eu/internal_market/company/ecgforum/studies_en.htm

² Feedback Statement, Summary of responses to the Commission Green Paper on the EU Corporate Governance Framework, 15 November 2011, http://ec.europa.eu/internal_market/company/docs/modern/20111115-feedback-statement_en.pdf

Practical rules

1. The ‘comply or explain’ principle for the 2009 Code is binding (law of 6 April and Royal Decree of 6 June 2010).

Article 96, paragraph 2, clause 1, no.2 of the Company Code stipulates that any company that does not fully apply the corporate governance code must indicate which sections of the code it is not complying with and give justified reasons for this deviation. The meaning of the term ‘justified reasons’ is not specified.

2. The declaration cannot rely solely, explicitly or implicitly on some general belief that application of the Code would be inadequate or inappropriate.

Criticism of the 2009 Code, its principles and provisions cannot be the only justification for deviation.

3. If a company deviates from a provision of the Code, the reasons why must be specified in the Corporate Governance Declaration.

The reasons justifying the deviation must be set out in the company’s Corporate Governance Declaration, preferably in a separate section from the declaration itself. This means that the company must check whether or not it is fulfilling each provision of the Code.

4. Companies are advised to first mention which provision of the Code it is deviating from, and then to explain the reason for this deviation.

Shareholders must be able to clearly and transparently determine deviations by companies in which they own shares. Only in so doing will shareholders become aware of these deviations and be prompted to examine them.

5. A description of these deviations must be submitted to the Board of Directors to verify the quality of each explanation and check whether there are any additional reasons why the company deviates from the Code.

- The Board of Directors assumes responsibility for the quality of the explanations or the reason for the deviation. It verifies the quality of explanations, assesses the description submitted to it and evaluates whether or not there are any further deviations.
- In this connection, the Board of Directors can seek advice from one of its committees. Non-executive directors may monitor this process. In companies with a controlling shareholder, independent directors can also be granted a special role in this context. The remuneration committee – legally comprising mainly independent non-executive directors – could maybe fulfil this role.

6. The Board of Directors must approve the reasons given and endorse their content.

- Reasons must always comply with both their underlying principle and the spirit of the Code.
- Reasons must relate to the company's defining features and situation (e.g. with regard to its sector, size, structure, international character, etc.) and specify how these features justify the deviation in question.
- Reasons must be sufficiently detailed and provide a clear enough idea of the justification for the deviation, so that the recipients can assess the impact of the information they are given.
- Temporary deviations must specify why they will be temporary, when this temporary situation will end and, where appropriate, whether the company has now fulfilled the provisions of the Code.

7. Explanations must be submitted to the General Assembly when the Corporate Governance Declaration is presented.

Above all, explanations must provide greater clarity. In this respect, the Committee stresses that the clear reason given must not get lost in the details.

The board should endeavour to ensure that shareholders carefully consider the explanations given for deviating from this Code and encourage them to make reasoned judgements in each case. It must also encourage them to arrive at informed judgements (provision 8.13, section 1).

The board should engage in a dialogue with shareholders if those shareholders do not accept the company's position, bearing in mind in particular the company's size and complexity and the nature of the risks and challenges it faces. (provision 8.13, section 2).

8. Every year, the reasons for deviating from the 2009 Code must be submitted to the Board of Directors for evaluation.

Each year, the Board of Directors must examine the current reasons and their relevance to the current situation and the future.

Annex – May 2016

On 9 April 2014 the European Commission published a recommendation on the quality of corporate governance reporting ('comply or explain'). The recommendation aims to encourage companies to comply with the applicable corporate governance code or to better explain any non-compliance. To that end, the recommendation includes guidelines intended to improve the general quality of corporate governance statements and, in particular, the quality of explanations companies provide in those cases where they deviate from the recommendations set out in the applicable corporate governance code.

The Corporate Governance Committee's practical rules are, to a large extent, consistent with the European Commission's recommendation. However, the practical rules do deviate from the EU recommendation on two points. Accordingly, for each deviation from an individual recommendation, the company must:

- describe how the decision to deviate from the recommendation was arrived at within the company (section 8, (c));
- where appropriate, describe the measure taken as an alternative to compliance with the recommendation, and explain how that measure achieves the underlying goal of the specific recommendation or the code as a whole, or clarify how it contributes to good corporate governance by the company (section 8, (e)).

The Corporate Governance Committee decided not to modify its practical rules, but to alert listed companies about the existence of the European Commission's recommendation and the differences between the recommendation and the Corporate Governance Committee's practical rules.