



**CENTRE FOR
EUROPEAN
POLICY
STUDIES**

Corporate Governance Reform in the EU

Outline for a CEPS Task Force

Chairman: Paul Arlman, Secretary General Federation of European Securities Exchanges (FESE)

Rapporteurs: Joe McCahery, University of Tilburg
Arman Khachaturyan, Visiting Fellow, CEPS

Corporate governance remains high on the policy agenda in the industrialised countries. After the corporate scandals in the US, problems in well-respected corporations continue to hit public attention. Unlike the 90s, when the task was largely left to self-regulation, authorities have become impatient to see firms apparently incapable of regulating themselves according to the codes they have subscribed to. However, tighter regulation of corporate governance matters raises fundamental questions regarding the role of public policy in this area, the feasibility to address these problems in detailed legislation, and the impact on the performance of enterprises.

Further to the European Commission's May 2003 Communication on the subject, which announces a broad European agenda in the area of corporate governance, CEPS decided to create a task force to critically evaluate the different proposals for public intervention and to come up with some alternatives. The task force will critically evaluate the proposals contained in the EU's communication, but also address related and broader policy issues.

1. Corporate Governance Reform

The recent corporate governance scandals in the US caused substantial losses to investors. US lawmakers, responding rapidly to the crisis, passed the Sarbanes-Oxley Act designed among other things to counter governance failures. The wave of US regulatory reform that followed the collapse of Enron has spilled over into Europe. The Sarbanes-Oxley Act e.g. directly applies to non-US firms that are listed on a US exchange, and obliges EU audit firms to register with the United States Public Accounting Oversight Board (PCOAB).

The indirect effect of the events and regulatory developments in the US has been to provoke a host of parallel reforms in the EU. EU policy makers have variously been motivated by a concern to ensure that US collapses are not replicated in the EU, a

desire that domestic and EU legislation reflect ‘best practice’, and the need to give credibility to claims of regulatory parity for purposes of negotiations over the extraterritorial impact of the US law.

The European Commission has also undertaken steps to modernize the European framework for company law and corporate governance, starting with the appointment of the High Level Expert Group on Company Law to provide guidance. In their second report, the Group recommended *inter alia* strengthening mandatory disclosure obligations for listed companies, granting special investigation rights to minority shareholders, and considering the introduction of a disqualification sanction for directors associated with misleading disclosures. Besides these reforms to disclosure obligations, the Group suggested the development of a UK-style corporate governance codes of best practice, primarily enforced by markets through ‘comply or explain’ mechanisms, improved investor access to corporate information through the use of electronic dissemination facilities, and the strengthening of shareholders’ rights to vote via electronic means. The Group’s recommendations have served as critical influences in shaping the Commission’s program on Modernizing Company Law and Enhancing Corporate Governance.

The European Commission has taken over most of the proposals of the High Level Group in its May 2003 Communication. Policymakers and experts disagree, however, over whether all of the EC’s proposed reforms are desirable or even feasible. It announces 17 legislative and 7 non-legislative measures in the area of corporate governance. The Communication proposes, amongst others, the harmonisation of the collective responsibility of board members at the European level, the annual disclosure of key elements in corporate governance structures and practices by all EU-listed companies following a local code, the disclosure of investment policies by institutional investors and the creation of a European Corporate Governance Forum to coordinate the corporate governance efforts of the member states.

In this sense, the task force should analyse whether the strategy proposed by the European Commission is possible. It should discuss the need and feasibility of further harmonisation of the elements proposed in the Communication and propose alternatives, if any.

In the meantime, the European Commission has already started a consultation regarding the remuneration of directors, which should lead to a recommendation on an appropriate regime for directors remuneration. It is thus clear that the European Commission will proceed firmly.

The measures as proposed in the connected statutory audit Communication are probably more useful and more consistent with previous positions of the Commission on the subject, although here also the impact of events across the Atlantic can clearly be noticed. Approximately 2 million statutory audits are conducted annually in the EU subject to member state regulations. Measures proposed by the statutory audit Communication are intended to harmonise both the regulatory framework for statutory audits as well as to enhance their independence and quality.

2. Cross Border Reorganizations and Corporate Restructuring

The European Commission has introduced a new company law proposal on cross-border-mergers and is planning shortly to issue a directive on the cross-border transfer of residence for domestic corporate business, following the lines of the Statute for A European Company. Moreover, the European Commission has promulgated a Proposal for a Council Directive amending Directive 90/434/EEC on a tax system for mergers, divisions, and the transfers of assets and exchanges of shares. This measure will extend the scope of the merger tax directive to the European Company and the European Cooperative Society. It provides rules designed to deal with the consequences of a transfer of registered office, the valuation of shares by the acquiring company, and includes split-offs within the Directive. Even though these measures are intended to enhance cross-border mobility, they are hardly able to meet the challenge since they only deal with the European Company and the European Cooperative Society and do not include the factual transfer of the place of central management and control.

The task force will critically examine the Commission's new proposals on cross-border reorganizations to answer question whether an optimal system of cross-border restructuring is likely to emerge.

3. Small and Medium Size Firms

Close corporations and partnerships have become the preferred vehicle for small and medium-sized enterprises in Europe. While scholars have debated the advantages of close corporation statutes for more than a decade, some who favor reform suggest that lawmakers devise new business organization statutes that are more varied, less complex, and can potentially enhance efficient outcomes. Indeed, since in most jurisdictions close corporations are a mirror image of their publicly held counterpart, small and medium-sized enterprises are burdened by a number of regulatory requirements, which cause them to incur substantial costs in carrying out their normal business activities. In particular, the imposition of many of the European Community's harmonized corporate law provisions on smaller firms is viewed as disproportionate and over-regulatory, and tends to impede the development of an efficient supply of legal rules. Reform-minded scholars, supported by product and capital market pressures to supply the most competitive business statute for small and medium-sized enterprises, point to the success of the US Limited Liability Company (LLC), a flexible business form that combines the best features of partnership and corporate law.

The task force will consider whether making new business forms available in the European Union could lead to an increase in the number of start-up firms while also satisfying the needs of range of established firms to manage their liability concerns.

4. Organisation of the CEPS task force

Given the urgency of the issue in the eyes of public policy makers, CEPS proposes to convene a task force to report to the new European Commission on these matters by early 2005. This task force will be composed of company secretary generals and corporate governance experts. A first meeting, foreseen for 17 June 2004, will set the agenda of the task force. Two further meetings will follow in the second half of the year leading to a final report setting the main recommendations of the task force.

As corporate governance has been widely discussed in Europe for over a decade now, it is not our intention to replicate these discussions. On the contrary, we would specifically limit ourselves to the proposals contained in the Commission's communications and the other measures discussed above to come forward with an alternative plan for action.

CEPS has broadly covered the capital markets and corporate governance matters in the recent past. Its 1995 report on Corporate Governance in Europe was widely quoted and led to many debates on the grounds for EU policy action in this area. CEPS has also recently published papers on the takeover bids directive and the regulatory framework for disclosure in the EU.

8/26/2009



Corporate Governance Reform in the EU

Registration Form

The participation fee is 1,000 €for CEPS Corporate Members and 5,000 €for non-members. **Please note that the first meeting is free of charge.**

I wish to participate in the Task Force:

Name:

Position:

Company:

Address:

.....

Telephone:

Fax:

e-mail:

VAT:

- My company is a corporate member of CEPS and pays 1000 euro (+ 21% VAT).
- My company is not a corporate member of CEPS and pays 5000 euro (+ 21% VAT).

Please return to: Isabelle Tenaerts,
CEPS, 1 Place du Congrès,
B - 1000 Brussels,
Tel 32.2.229 3956 - Fax 32.2.219 4151.
e-mail: isabelle.tenaerts@ceps.be