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Recommendations on Corporate Governance

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Introduction

The development of the securities markets has led to intensive reflection on the structure and control of publicly-held companies. A problem that is by no means new, it has been generally labelled a corporate governance issue, and has gained diffusion in all international markets through its relation to the universal question of developing investor control mechanisms.

Corporate governance is used to describe the system of rules and procedures employed in the conduct and control of listed companies. This corporate governance analysis *does not seek to impose rigid and uniform models*. Its objective is to contribute to the optimisation of company performances and to favour all those people whose interests are involved in the work of the company – investors, creditors and workers.

Corporate governance has, to this extent, an *internal* aspect and an *external* aspect: the first meaning is understood as the set of organisational rules within each listed company; external control, in turn, relates to the assessment of the performance of the company which is conducted through the normal function of market mechanisms, a domain in which the proceedings of institutional investors are of capital importance.

The internationalisation of companies makes it important to bring the security and organisation parameters of market agents to the same level. Thus, *as a result of the globalisation of markets, with the decisive impetus of the introduction of the euro, Portugal cannot distance itself from this problem*.

In this respect, based on the conviction that the national legal system is sufficiently equipped with solutions which, although they do not use this designation, already provide a response to the problems related to this issue, it is through the presentation of a set of recommendations that this document seeks to transpose to the national context the relative reflection of the governance of listed companies.

By aiming to inaugurate a critical reflection, in Portugal, on corporate governance, these recommendations intend to be presented not just as the minimum denominator on the matter, but also as a range of indications adapted to the legal and market context in Portugal. Although the core of the problem is related to companies with listed shares and with institutional investors, these recommendations may, naturally, be also followed by non-listed companies.

As this document comprises a set of recommendations, the market's assessment of its acceptance is fundamental. It is, indeed, the market itself that constitutes the main assessor of the excellence of the leadership and control options adopted by listed companies and institutional investors. Thus, like the practices followed in other markets, **it is recommended that listed companies and institutional investors include a mention in their annual reports of the adoption or degree of adoption of these recommendation with the grounds for this adoption.**

These recommendations are intended to be understood as recommendations *by* and *for* the market. This is, therefore, a document open to assessment and suggestions and, as such, is subject to revision and amendment.

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I – Disclosure of Information

1. Information should be disclosed on the sharing of powers between the different bodies and departments or divisions of the company within the framework of the corporate decision process, particularly through flowcharts or functional maps.

> *With the growing complexity of the corporate decision processes, a formal and ritualised analysis of the distribution of powers between the different decision-making bodies in a company has become, as a general rule, insufficient. It is recommended that for these matters which are central to the configuration of corporate governance, information be disclosed, even if only summarised, on the special procedures of decision, particularly regarding the company's strategic options.*

2. Information should be disclosed on the actual functions of each member of the board of directors and executive management of the company, as well as their positions in other companies.

> *It is important to prevent situations of conflict of interest between the sphere of influence of a member of the board of directors or executive management and the sphere of influence of the company in question. The law is already aware of this issue, namely in Articles 398 and 428 of the Portuguese Companies Act (Código das Sociedades Comerciais), this recommendation being intended to strengthen, in the light of principles of good practice, transparency in the management of companies.*

3. A description of the market behaviour of the shares should be made and issued at least once a year.

> *It is recommended that board presents a brief description of the development in in market value of the shares of the issuing company, taking into account relevant facts, in particular the issue of shares or other securities that grant share subscription or acquisition rights, the announcement of results and the payment of dividends per category of shares with an indication of the net value per share, so as to allow investors to formulate an opinion in relation to the market behaviour of that year.*

4. Information should be disclosed to the public on the dividend policy commonly adopted by the company.

> *The right to company dividends is one of the most important rights in the legal sphere of the shareholder. The law does not directly impose a quantification of this right, merely requiring that the distribution of less than one half of the distributable profit should be preceded by a provision in the statutes or a deliberation by an especially qualified majority of votes. In this respect, determination of the percentage of the profits that is, in fact, distributed, also constitutes a manifestation of corporate autonomy. Therefore, to clarify the share investment decision, the investor should be informed about the dividend distribution policy commonly adopted by the company, with the proviso that this dividends policy may – and in some cases, should – be corrected in accordance with the actual circumstances faced by the company at the moment moment of decision on the application of the distributable profit.*

5. Shareholder agreements regarding the exercise of rights in the company or regarding the transferability of shares, when relevant to the organisation of companies, should be disclosed to the public.

Throughout the European financial area, the statement of controlling situation requires that consideration should be given not only to the shareholding stake, but also to the shareholder agreements executed in relation to rights in the company. The shareholder agreements regarding publicly-held companies should, therefore and in accordance with rules of market transparency, be subject to disclosure as regards the part in which they denote an organisational effect – a requirement established expressly in the new Securities Code (Código dos Valores Mobiliários). Voting agreements and other shareholder agreements to contest takeover bids are considered shareholder agreements with organisational effects on the company for this purpose.

6. The use of new information technologies is encouraged for the disclosure of financial information and of preparatory documents for General Meetings.

The use of new information technologies, such as the Internet, may facilitate the preparation of General Meetings, favouring a rationalisation of the costs and and time involved. New technologies are, therefore, not only an instrument for the modernisation of listed companies, but also a requirement of the globalisation of markets.

7. The company should ensure the existence of permanent contact with the market, respecting the principle of equality for shareholders and taking precautions against asymmetries in access to information among investors. For this purpose, the creation of an investor information department is recommended.

The creation of an investor information department is a common practice in our capital market which should be encouraged, since it is one of the measures that that allows centralisation of all question raised by investors and the necessary explanations that may be provided with the disclosure of this information to the market, when this is judged appropriate.

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II - The Exercise of shareholder Voting and Representation Rights

8. The active exercise of voting rights should be stimulated, whether directly (postal) or by representation.

> *The generic regulations set out in the Portuguese Companies Act (Código das Sociedades Comerciais) on the exercise of voting rights leave room for companies, in their own statutes, to establish measures to stimulate the exercise of this right, in order to combat the frequent absence of shareholders at General Meetings. In the line of this philosophy, the new Secutiries Code (Código de Valores Mobiliários) has confirmed the principle of admissibility of postal votes at general meetings of publicly-held companies and developed the system of representation of shareholders, by proxy, a sign of a legislative development that should be accompanied by practice in companies.*

9. The principles of good practice and transparency which should inform corporate governance recommend that the procedures related to requests for proxy voting at general meetings should be developed. In particular, it is fundamental that shareholders are provided not only with the information necessary to take a correct decision regarding the stipulation of voting instructions, but also that the grounds explaining how the representative should vote be clear, especially in the event of lack of instructions from the shareholder represented.

> *The Portuguese Companies Act (Código das Sociedades Comerciais), in Article 381, already safeguards the position of the shareholder represented at a General Meeting in situations of proxy requests to more than five of shareholders. However, both these situations and all the other situations regarding the exercise of voting rights by proxy, justify added care in guaranteeing the availability of suitable information for the shareholder represented, especially in cases of decisions of exceptional importance to the life of the company or decisions verging on conflicts of interest, so as to allow the shareholder to take an informed decision about how to vote. It is also especially important that the representative transmits to the shareholder represented the grounds for his vote, in the absence of instructions from the shareholder.*

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III - Institutional Investors

10. Institutional investors should take into consideration their own responsibilities for diligent, efficient and critical use of the rights conferred by the securities of which they are holders or whose management has been entrusted to them, in particular as regards information and voting rights.

> *With the development of securities markets, the independence of the role conferred on institutional investors (namely, investment fund management companies, pension fund management companies and asset management companies) is becoming clearly pronounced. Furthermore, empirical studies have revealed that the diligence of institutional investors in the management of rights attached to securities under their management, required indeed by law, makes a positive contribution on the performance of listed societies. Hence, in this context, it is important to stress the diligent, efficient and critical use of rights conferred by the securities whose management has been entrusted to the institutional investors.*

11. Institutional investors should disclose information on the practice followed regarding the exercise of voting rights on securities whose management has been entrusted to them.

> *It is important to allow the market to easily assess the attitude of institutional investors to the governance of listed companies. This is particularly the case for for investment fund management companies, whose use of the rights attached to the securities that make up the fund assets should be transparent in relation to all the participants in the fund.*

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IV – Company Internal Regulations

12. It is recommended that, within the internal organisation of the company, specific regulations be established aimed at regulating situations of conflict of interest between members of the board and the company, as well as the main obligations resulting from duties of diligence, loyalty and confidentiality of the members of the board, particularly regarding the prevention of improper use of business opportunities and company assets.

> *In order to ensure that the principles of good practice, by definition universally applicable to any company organisation, have effective application in the life of the companies, it is necessary to allow for the specific characteristics of the company in question (i.e. dimensions of the company, shareholders, management experience). In line with guidelines already established by law, namely Articles 397, 398, 410(6), 428 and 437, all from the Portuguese Companies Act (Código das Sociedades Comerciais), this recommendation is intended to encourage the appearance or development of codes of conduct and and internal regulations with respect to sensitive matters, such as conflict of interests, confidentiality or diligence in managing the company. Internal control procedures, besides the possibility of them having a significant impact on the level of corporate efficiency, are thus privileged means to guarantee transparent corporate governance.*

13. Measures adopted to prevent the success of takeover bids should respect the interests of the company and its shareholders. Measures considered contrary to these interests include defensive clauses intended to cause an automatic erosion in company assets in the event of transfer of control or change of composition in the board, detrimental to the free transferability of shares and the free assessment by shareholders of the performance of members of the board.

> *Efficiency of the shareholder control market is based essentially on the right to transferability of shares, on the unwaivable possibility granted to the shareholder to assess the situation of the company and on the responsibility of its leaders for the results obtained. These principles require a distinction to be made between benign defensive measures and those that harm the rights and expectations of shareholders and the market in general. For this reason, it is important to condemn the adoption of certain defensive measures which, seeking at all costs to contain the success of takeover bids without the agreement of the board, end up damaging the interests of partners and the company.*

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V – Structure and Role of the Board of Directors

14. The board should be composed of a number of members who provide effective guidance for the management of the company to its managers.

It is important that the board exercises effective control in its guidance of the company, reserving decisions on important matters. To pursue this objective, it should meet at regular intervals, be duly informed at all times and ensure the supervision of the management of the company.

It is to be noted that each board should balance the number of members with the due efficiency, taking into consideration that an excessive number of members may hamper the desired cohesion and contribution of each member in discussion and decision taking. In turn, the efficiency of board meetings depends significantly on the diversity of opinions and the vitality of the deliberation process. For this reason it is advisable that all members be present, participate in the discussions and make independent judgements when when taking a stand.

15. The inclusion of one or more members who are independent in relation to the dominant shareholders in the board is encouraged, so as to maximise the pursuit of corporate interests.

The composition of the board of directors should be planned so that during the management of the company not only the interests of the group of shareholders shareholders with a majority of shares are considered. Independent members should exercise a significant influence on collective decision taking and should contribute to the development of the company strategy, thereby favouring the interests of the company.

16. If an Executive Committee is created, its composition should reflect, insofar as it is possible, the balance existing in the board between directors linked to dominant shareholders and independent shareholders. In accordance with the principle of transparency, the board should be informed, at all times, of the issued under discussion and decisions taken by the Executive Committee.

The creation of an Executive Committee can prove to be a valuable instrument in the heart of complex corporate organisations. In order to prevent a reduction in the influence of independent members on the structure of corporate governance, it is advisable for the composition of this Committee to be a faithful reflection of the balance within the board. Despite the power of the board to take decisions on matters delegated by the Executive Committee, as well as its responsibility for monitoring the activities of this committee, being already established by law, in Paragraph 5 of Article 407 of the Portuguese Companies Act (Código das Sociedades Comerciais), it is recommended that the relations between these two bodies be guided by the principle of transparency and, for this purpose, procedures be created when necessary to ensure that the board has, at all times, full knowledge of the matters discussed and decisions taken by the Executive Committee.

17. The board is encouraged to create internal control committees with powers conferred for matters in which there are potential situations of conflict of interests, such as the nomination of directors and managers, the analysis of the remuneration policy and assessment of the corporate structure and governance.

As a general rule, the function of these committees should be basically informative and consultative, since they are not supposed to replace the board in decision taking but rather provide it with information, advice and proposals that may help it efficiently develop its function of supervision and increase the quality of its performance in these matters.

It is not necessary to create a different committee with powers in each of the matters, neither need the members of each committee be different; however, it is not recommended to unite all responsibilities in one single committee, because of the risk of reducing its efficiency due to an excess of work and concentration of powers.