

# Swedish Code of Corporate Governance

*Report of the Code Group*



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Swedish Government Official Reports  
SOU 2004:130

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SE-106 47 Stockholm  
Sweden

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Printed by Elanders Gotab AB  
Stockholm 2005

ISBN 91-38-22309-0  
ISSN 0375-250X

## To Thomas Bodström, Minister for Justice

On September 30, 2004 the Government appointed a committee instructed to review the comments received in response to circulation of the report, Swedish Code of Corporate Governance, a Proposal by the Code Group (SOU 2004:46), to make the revisions to the proposed code deemed appropriate by the committee, with due consideration for the views expressed in the comments and the debate surrounding the code proposal, and to draw up a revised code. The directive (Dir. 2004:132) can be found in Annex 1 of this report. Erik Åsbrink was appointed chairman of the committee. Other members were Rune Brandinger, Claes Dahlbäck, Karin Forseke, Lars-Erik Forsgårdh, Eva Halvarsson, Arne Mårtensson, Marianne Nivert, Lars Otterbeck, Henrik Paulsson and Bengt Rydén. The Committee appointed Patrik Tigerschiöld as adjunct member. Rolf Skog, Lars Thalén and Per Thorell participated as experts. Secretary to the committee was Per Lekvall and Björn Kristiansson was assistant secretary on a part-time basis.

The committee adopted the Code Group as its name.

In the directive, the Government instructed the committee to make its report no later than December 17, 2004.

The initial work developing the Code was conducted by a special working group called the Code Group as a joint effort of the Commission on Business Confidence (Förtroendekommissionen) and the following bodies and organisations in the business community: FAR (the institute for the accountancy profession in Sweden), the Swedish Investment Fund Association, the Swedish Industry and Commerce Stock Exchange Committee (NBK), the Stockholm Stock Exchange, the Stockholm Chamber of Commerce, the Swedish Bankers' Association, the Swedish Securities Dealers Association, the Confederation of Swedish Enterprise, the Swedish Shareholders' Association and the Swedish Insurance Federation. The Group's composition is given in the foreword to

the report, Swedish Code of Corporate Governance, a Proposal from the Code Group (SOU 2004:46), submitted on April 21, 2004. The report was then circulated for comments. A total of 78 responses were received. A list of the responses can be found in Annex 2 of this report. These comments are available at the Ministry of Justice. The Code can be found in Annex 3 of the report.

The committee had four formal meetings between October and December 2004.

The committee is now pleased to present its report, the Swedish Code of Corporate Governance. With this report, the committee has completed its work.

Stockholm, December 16, 2004

Erik Åsbrink

Rune Brandinger

Claes Dahlbäck

Karin Forseke

Lars-Erik Forsgårdh

Eva Halvarsson

Arne Mårtensson

Marianne Nivert

Lars Otterbeck

Henrik Paulsson

Bengt Rydén

Patrik Tigerschiöld

/Per Lekvall

Björn Kristiansson

# Contents

<b>1</b>	<b>General Comments .....</b>	<b>7</b>
1.1	Reasons for a Swedish Code of Corporate Governance .....	7
1.2	Self-Regulation Under the Principle “Comply or Explain” .....	8
1.3	Target Group.....	10
1.4	Level of Detail and Other Considerations .....	13
1.5	Redistributing Responsibilities among Corporate Governance Bodies .....	16
1.6	International Harmonisation .....	17
<b>2</b>	<b>The Ownership Role and Responsibility .....</b>	<b>21</b>
<b>3</b>	<b>Rules for Corporate Governance .....</b>	<b>23</b>
3.1	The Shareholders’ Meeting.....	23
3.2	Appointing the Board and the Auditor .....	26
3.3	The Board of Directors .....	35
3.3.1	The Role of the Board of Directors .....	35
3.3.2	Size and Composition of the Board .....	36
3.3.3	The Directors.....	40
3.3.4	The Chair of the Board of Directors.....	41
3.3.5	Board Procedures.....	43
3.3.6	The Board of Directors and Financial Reporting .....	44
3.3.7	The Board’s Internal Control and Internal Auditing .....	46
3.3.8	The Board - Auditor Relationship.....	47

3.4	Senior Management.....	50
3.5	Auditors .....	52
3.6	Information on Corporate Governance .....	55
<b>4</b>	<b>When will the Code come into effect? .....</b>	<b>57</b>

#### **Annexes**

<i>Annex 1</i>	Committee Directive.....	59
<i>Annex 2</i>	List of Consultees.....	65
<i>Annex 3</i>	Swedish Code of Corporate Governance.....	69

# 1 General Comments

This section discusses a number of the general comments on the proposed code. Only those matters and comments that the Code Group deemed were of major importance and were relevant to the work at hand are considered.

## 1.1 Reasons for a Swedish Code of Corporate Governance

### *Summary of the Comments*

An overwhelming majority of the respondents support the proposal to establish a Swedish corporate governance code. Only two respondents took exception to the idea as such. The investment company Nordstjernan is of the opinion that any regulation of the market that is needed should be done exclusively by legislation. The Federation of Private Enterprises, which according to its own statement represents primarily owners of small, unlisted companies, does not share the view that there is a general need for more regulation of corporate governance in Sweden. In addition, some respondents, particularly H&M Hennes & Mauritz and L E Lundbergföretagen, think that the Code is relevant only for companies with mainly institutional ownership and therefore it should not apply to companies with a distinct and active private owner.

### *Deliberations and Conclusions*

In light of the comments made, the Code Group does not believe that there is reason to reconsider its view on the need for a Swedish corporate governance code.

## 1.2 Self-Regulation Under the Principle “Comply or Explain”

Under the proposal, companies that apply the Code are to either follow its rules or explain and give reasons for any material departures. This principle, “comply or explain”, was introduced by the Cadbury Committee in the United Kingdom in 1992. In the corporate governance codes of other countries, it is the predominant principle on how these codes are to be applied. The EU Commission has also expressed the opinion that this principle is appropriate for corporate governance codes.

### *Summary of the Comments*

With the exception of Nordstjernan, the respondents raised no objections to the proposal to apply the principle of comply or explain. However, several of the respondents would like the code to provide a fuller explanation of what the principle means. Among the respondents voicing this concern were the Stockholm Stock Exchange, the Swedish Association of Exchange-Listed Companies, the Confederation of Swedish Enterprise, the Swedish Bar Association, the Swedish Investment Fund Association, the Third AP Fund, H&M and Castellum. Some respondents believe that the Code should explicitly encourage adopting a critical attitude in applying the Code and making use of the opportunity to explain material departures. They also believe that the Code should point out that such explanations should be considered part of the normal course of events. Skandia states that no one knows how declared departures from the Code will be portrayed in the media and perceived externally; therefore, there is a risk that ranking lists in newspapers and similar publicity will, in practice, force companies into unwarranted compliance with the Code or, alternatively, to delist. The Swedish Bar Association states that expectations and requirements of market actors – for example, from marketplaces or potential investors – may, in practice, compel some companies to apply the Code’s material rules without any realistic possibility of explaining any departures. The Swedish Public Relations Association points out that the proposed code provides no clear examples of how these rules are to be applied and perceives a risk that the preferential right of interpretation will be usurped by the media

and it will be members of the media that pass judgement. The Swedish Insurance Association thinks that “is to” should be changed to “should”. This wording would allow for a more ambitious code while natural departures from the rules would not need to be justified.

The Swedish Association of Exchange-Listed Companies, the Confederation of Swedish Enterprise, and the First and Third AP Funds say that there is a need to state more clearly that neither a future code management body nor the Stockholm Stock Exchange, nor any other body, is to be assigned the task of approving companies' explanations for departing from rules. The Swedish Financial Supervisory Authority takes the opposite position. According to the Authority, the code management body should develop and oversee the quality requirements that need to be established for the wording of a declaration and develop a practice that is published regularly. Consideration should also be given to whether the body managing the Code is to have recourse to any remedial measures against too lax an approach to such explanations.

Some respondents, including the Stockholm Stock Exchange, the Stockholm Chamber of Commerce and Castellum, think that there needs to be clarification of who is to be responsible for explaining decisions or measures taken by persons or bodies other than the board of directors, for example decisions of individual shareholders or the nomination committee. The Confederation of Swedish Enterprise suggests that it should be sufficient for the board of directors and company management to explain the departure by stating that the body that the rule was aimed at has departed from the rule. The board or company management should be obliged to provide an explanation only if they have actually received one from the body concerned. The Swedish Securities Dealers Association would like to see further clarification of the obligation to explain for companies that are listed in several countries and therefore may have to follow several different corporate governance codes.

*Deliberations and Conclusions*

The Code Group has to a large extent taken the respondents' views into account. The introductory section in that part of the Code dealing with the principle of comply or explain has been expanded to include more specific instructions on how to understand the principle. The Code Group does not share the opinion there should be a body with the authority to use some form of remedial measures in the event of inadequate explanations. Nor has changing the Code's requirements from "is to" to "should" been deemed appropriate because there would be a risk that such a change would make it unclear when departures from Code provisions have taken place and an explanation is thus to be provided.

**1.3 Target Group**

Under the proposed code, the rules are primarily aimed at stock market companies, that is, Swedish limited liability companies with shares listed on a stock exchange or authorised marketplace. Whether other types of companies should apply the Code is a decision to be made by the companies' owners or the other marketplaces where the companies may be listed.

*Summary of the Comments*

A large number of respondents believe that small companies should be exempted from the Code. The Swedish Association of Exchange-Listed Companies, the Confederation of Swedish Enterprise, the Swedish Securities Dealers Association and Skandia suggest exempting small companies during a transition period, tentatively two years, and at the end of that period, evaluating the possibility of expanding its application. Some respondents suggest a company's market value as the criterion for defining what is considered a large or a small company while others recommend deciding size according to the list on which it appears. According to AktieTorget, only companies listed on the Stockholm Stock Exchange's A-list should be included, the Swedish Academy of Directors would include only companies listed on the Stockholm Stock Exchange's A-list, possibly supplemented with companies

over a specific size on other lists, and Skandia would include only the 30 largest companies on the Stockholm Stock Exchange.

The Swedish Investment Fund Association, AktieTorget, Styrelsepoolen, the Third AP Fund, AMF Pension and L E Lundbergföretagen are of the opinion that it should be easier for the smaller companies to exempt themselves from all or parts of the Code. Alecta says that for smaller companies, a more positive approach to the Code would be for them to state in what respects they are applying the Code, rather than devote resources to describing and giving reasons for departing from rules. L E Lundbergföretagen and H&M think that privately owned companies with distinct owners who actively exercise their ownership role should be completely exempted from having to apply the Code since it is their understanding that the code proposal is primarily written for companies dominated by institutional owners.

The Swedish Shareholders' Association thinks that the Code is to cover all stock market companies and that it should also include foreign limited liability companies listed in Sweden. The Swedish Securities Dealers Association, the Stockholm Stock Exchange, the Fourth AP Fund and Castellum believe that all stock market companies could apply the Code if its level of detail is substantially reduced.

### *Deliberations and Conclusions*

The Code Group's mandate does not allow it to prescribe what companies are to apply the Code. Only stock exchanges, marketplaces and company owners can decide by means of contractual or other bases the manner in which a company handles corporate governance matters. The Code Group can only draw up the Code so that it is broadly applicable to different types of companies and make recommendations on what companies should apply it.

The basis for the Code Group's work has been that a corporate governance code is most justified for companies that have, in addition to possible principal owners, a diverse group of shareholders, who cannot each be expected to have the expertise and resources that major shareholders have to follow developments in the company. Shareholders who purchased their shares on a stock exchange or other marketplace in particular have the right to expect that the company is governed in accordance with generally

accepted good practice. From this perspective there is no reason to restrict the Code's application to specific stock market companies, for example, large companies. It is the opinion of the Code Group that there is no reason to assume that corporate governance in small companies is generally better than in large companies. The Code Group considers good corporate governance to be as important in small companies as it is in large companies; therefore, all stock market companies should be applying the Code within a few years at least, irrespective of their size. To make this possible, the level of detail has been reduced (see section 1.4), the rules deemed too burdensome for small companies have been reformulated to allow room for their implementation in a simplified way and some limitations on the corporate governance report that the company is to present annually have been introduced. Furthermore, in addition to listed companies, other categories of companies with a diverse ownership or public interest – for example, co-operatives and mutual associations, state and municipally owned companies and mutual insurance companies – as well as many privately owned companies should also be able to apply most of the rules in the Code.

The Code Group's premise is that to begin with, the companies listed on the Stockholm Stock Exchange should be obliged to apply the code in the near future. There may be reasons for considering implementing it in stages, beginning with the largest and most able companies. The Group recommends as a first step introducing the Code in companies listed on the A-list and in the larger companies listed on the O-list. After a few years of experience have been gained applying the Code, coverage can be broadened to include all companies listed on the stock exchange. There are advantages to proceeding in this manner. The experience gained in the practical application of the Code can form the basis of possible modifications in connection with the extension of the Code to more firms. Furthermore, the larger companies will develop systems and routines for applying the Code in a cost-effective manner. Smaller companies can then make use of any relevant parts of such systems and routines. The larger stock market companies will thus bear a large part of the initial costs of establishing systems and routines for applying the Code.

Implementing the Code is also recommended for other exchanges and authorised marketplaces as well as other categories of companies in addition to stock market companies. It is the Code

Group's conviction that application of the Code will come to be viewed as a sign of quality that an increasing number of marketplaces and companies will consider important to acquire.

For a company listed on stock exchanges or marketplaces in several countries, its legal domicile should decide which country's code it is to follow. The Swedish Code is thus intended for Swedish limited liability companies. If a Swedish company is obliged to depart from certain rules in the Swedish Code because it is listed on a foreign stock exchange having mandatory rules that contravene the Swedish Code, this obligation should generally constitute a valid reason for a departure under the principle "comply or explain".

## 1.4 Level of Detail and Other Considerations

### *Summary of the Comments*

Many respondents have commented that the proposed code is too detailed, particularly in light of the proposal to apply it to small stock market companies also. In contrast several other respondents have proposed expanding some existing rules and adding new rules.

The Stockholm Stock Exchange recommends less stringent rules when the Code is introduced, followed by a gradual tightening. According to the Swedish Bar Association, detailed regulation within specific areas should be left to specialised bodies such as the Swedish Industry and Commerce Stock Exchange Committee. Moreover according to the Swedish Bar Association, expectations and requirements of market actors – for example, from marketplaces or potential investors – may, in practice, compel some companies to apply the Code's material rules without any realistic possibility of declaring material departures.

According to the Stockholm Stock Exchange, the Swedish Bar Association and TurnIT, the code proposal also contains some rules that state the obvious and some rules that are more like general principles. Such rules should be expunged in order to avoid giving the impression that they reflect general problems in Swedish businesses. Several respondents mentioned that the proposed code in some instances concerns issues that have been addressed in the Swedish Companies Act (1975:1385), thus causing problems of interpretation. Several respondents would also like to see the

Code's rules co-ordinated with other regulatory regimes in the area of stock exchange law. Otherwise, according to the Swedish Securities Dealers Association, users may be led to believe that one can depart from these rules by declaring and giving cause for the departure.

#### *Deliberations and Conclusions*

The Code Group has to a large extent taken note of the views critical of the proposed code's level of detail and a critical review of the reasons for including each rule has been conducted. As a result, some rules have been deleted while others have been reformulated more in the manner of principles. However, the aim has been to avoid doing this in a way that would water down the substance of the Code.

In addition, text considered to state what might appear to be obvious has largely been scrapped. Guidelines expressing principles considered to state good practice in the area but that are not appropriate rule text have in some cases been incorporated into the introduction to the section.

The matter of overlap with other regulatory regimes is somewhat more complicated. In its earlier proposal the Code Group's goal was to create as comprehensive a regulatory regime as could reasonably be expected, one that could convey a total picture of good Swedish corporate governance. Another aim was for persons less familiar with Swedish corporate governance rules, especially foreign readers, to be able to read and understand the Code. In some instances, this makes it necessary to repeat rules found elsewhere. On the one hand, strict application of the principle of only including matters not dealt with in other regulatory regimes would result in a code that would give a fragmented picture of Swedish corporate governance. On the other hand, there is a risk, as several respondents pointed out, of creating uncertainty about what actually is valid. In the opinion of the Code Group, this risk is limited with respect to legislation; obviously the law takes precedence over self-regulation. Nevertheless, most of the original proposal's overlap with existing law has been eliminated. The reason for the remaining overlap in certain places is that there would otherwise have been a fragmentary account of what is desired corporate governance. In addition, in some instances intro-

ductory text or comments have been used to give an overview of the existing law to make the rule easier to understand.

Somewhat more difficult is the matter of the proposed code's relationship to other forms of self-regulation. When such regulation is obligatory under the terms of a contract, such as some of the rules of the Swedish Industry and Commerce Stock Exchange Committee that are included in the Stockholm Stock Exchange's listing agreement, these rules of course cannot become optional under the Code's principle, comply or explain. But it is up to the contracting parties, in this case the Stockholm Stock Exchange and the companies listed there, to come to a mutual agreement on this matter. Since in the long term the Code will apply to a broader target group, it would be unreasonable for the Code to refrain from regulating a matter because it was included in a contractual agreement between other parties.

Nor can it be presumed that the Code is not to regulate a matter because other self-regulation deals with it. In addition to wishing to draw up a reasonably comprehensive code, the Code Group has aimed as much as possible to take the latest international developments into consideration, especially certain recommendations from the EU Commission on corporate governance. The criteria for assessing directors' independence as well as rules on senior management's remuneration are examples. The Code Group's priority for these two issues has been to adjust the Code to existing or forthcoming EU regulations rather than to other existing Swedish self-regulation. It will then be the task of a future code management body to work to co-ordinate Swedish self-regulation in this area.

Finally it should be mentioned that the Ministry of Justice has legislative work in progress on information and decisions on remuneration for the board of directors and senior management based on the proposals of the Commission on Business Confidence on these matters. If and when such regulation becomes statutory, the corresponding rules in the Code may possibly be scrapped. Since statutory regulation is not yet a reality, the Code Group has elected to retain the earlier proposal's rules in these areas. Also this question will have to be taken up by the future code management body.

## 1.5 Redistributing Responsibilities among Corporate Governance Bodies

### *Summary of the Comments*

Several respondents expressed misgivings that the Code might change the division of responsibilities among the governing bodies that make up the Swedish corporate governance structure.

The Confederation of Swedish Enterprise thinks that the Code's introductory text in particular should include a statement that the Code is not aiming to change the current division of responsibility among governing bodies.

The Swedish Securities Dealers Association points out that shifting tasks from one corporate governance body to another might upset the relatively clear division of responsibilities specified by the Swedish Companies Act. The Association assumes that this is not one of the Code Group's aims and it thinks that this should be pointed out in subsequent work. Moreover the Association believes that shifting decision making upwards and letting owners have control of an increasing number of important decisions does not necessarily lead to more influence for smaller shareholders. There normally is only one shareholders' meeting a year. Moreover, at this meeting a smaller circle of well-informed owners often dominate the decision making, while other owners may have difficulty asserting their rights. Decisions should be made by those having the best foundation in terms of access to information, responsibility and competence. In some matters the owners may have the best foundation for the decision, but in other matters, it will be the board of directors. What is important in the ownership role is exercising control; here, transparency is the most important factor. The Association therefore believes that for effective corporate governance, transparency is more important than formal decision-making processes and detailed rules on decision making.

H&M expresses surprise concerning the division of responsibility in the code proposal, such as the provisions on the role of the nomination committee, which they do not think are supported in the Swedish Companies Act. Castellum thinks that the Code should do more to uphold respect for ownership; for example, the decision taken at the annual general meeting on electing the board does not need to be explained afterwards.

*Deliberations and Conclusions*

The Code Group has been unable to identify any respect in which the proposed code would contravene or be likely to change the existing corporate governance structure legislated under the Swedish Companies Act. The Swedish Companies Act sets out the basic structure of corporate governance in the form of four governing bodies and their overall responsibility and roles in full, but within this structure, it leaves considerable room in the practical application of the Act for the division of the decision-making authority among the company bodies. In the Code Group's opinion, comments to the effect that there would be any departure from this basic structure – one example given is the proposed nomination committee – is based on a misunderstanding about which more detailed comments can be found in section 3.2.

However, in certain respects, the Code implies changes in decision-making procedures within this framework when compared to the customary application. This is true of some matters that concern remuneration and election of the chair of the board. However, this does not constitute a departure from the provisions of the Swedish Companies Act. A Swedish shareholders' meeting is sovereign to take up any matter it considers appropriate. In Swedish business, there are customary practices for the matters normally dealt with at each level of the system. However, such practices must not be sacrosanct; that would mean that all development would cease. Naturally within the structure provided by the law, it must be possible to introduce, both in an individual firm and in a corporate governance code, decision-making procedures on individual matters other than those commonly applied today.

## **1.6 International Harmonisation**

*Summary of the Comments*

A number of respondents expressed concern that the Code differs to some extent from the codes of other countries. One of the concerns they cited was the greater level of detail in the Swedish code. This difference may lead to problems for companies listed in several countries. To lessen this problem, the Swedish Securities Dealers Association suggests that in such cases, rather

than requiring detailed explanations for every departure from a rule in the Swedish Code, a declaration simply stating that another country's code is being followed should be acceptable. The Swedish Insurance Federation points out that some problems may occur when a company operating in many countries and listed on several markets has to decide which code to follow. The Fourth AP Fund believes that the richness of detail in the Swedish Code may make it difficult to market internationally, and this difficulty might, in turn, thwart the aim of strengthening the good international reputation of Swedish listed companies and marketplaces.

The Swedish Bankers' Association points out that even though a Swedish code should be harmonised with other countries' codes as much as possible, it must always remain in line with Swedish law and legal tradition in the field of corporate governance. It is the Association's view that the Code Group has not given sufficient consideration to this. Instead, it has paid too much attention to the Anglo-Saxon legal tradition and has been influenced by developments in the United States.

A few respondents, chiefly the Third AP Fund and Styrelsepoolen, point to the importance of harmonising Nordic corporate governance codes. Invest in Sweden Agency, Nordic Growth Market NGM and AktieTorget think that there is reason to wait for the results of the code work now underway in the OECD and the EU before a final version of the Code is adopted.

Among the foreign respondents, both the National Association of Pension Funds (NAPF) and Hermes Pensions Management would like to see rules against differentiated voting rights in Swedish listed companies.

#### *Deliberations and Conclusions*

Concerning international harmonisation, the Code Group's approach has been to diverge as little as possible from what can be considered the international standard, but to diverge without hesitation when justified. A Swedish code must be based on Swedish law and should take into account those distinctive features of the Swedish corporate governance structure considered worth keeping.

Following an international standard too closely risks producing a code that is alien to Swedish customs and practice. A code that

adopted the Anglo-American model in its entirety would probably contain certain unfamiliar rules, given the ownership structure on the Swedish stock market and the view of the ownership role and responsibility in Swedish companies. In contrast a Swedish code that differed too much from this model might lead to problems for companies listed in several countries and make it more difficult to attract international risk capital.

As previously mentioned, there are also recommendations from the EU Commission on certain matters. There are EU Commission recommendations in such areas as remuneration for senior management, directors' independence and board committees. The Commission has stated that the recommendations on these matters could be implemented in Member States by means of a corporate governance code.

The Code Group considers the issue of differentiated voting rights to fall outside the purview of the Code. The Code deals primarily with the organisation of company governance and management bodies and their work procedures and the interaction between these bodies, but not the distribution of power among the company's owners.

## 2 The Ownership Role and Responsibility

The proposed code contains a section discussing the ownership role and responsibility. The section is not part of the rules.

### *Summary of the Comments*

The Swedish Shareholders' Association and Private Property Forum believe that the time is ripe to set even higher requirements for institutional owners than those in the proposed code. According to the Swedish Shareholders' Association, the General Pension Funds and other funds linked to the premium pension system have a special responsibility for maintaining confidence in the stock market; therefore, these owners should be enjoined to exercise their voting rights under the principle of comply or explain. Institutionella ägares förening för regleringsfrågor på aktiemarknaden (Institutional Owners Association for Regulatory Issues in the Stock Market) and the First AP Fund are critical that the existing requirements in the section are aimed solely at Swedish institutional owners. According to the First AP Fund, the requirements should also apply to foreign institutions and private owners. According to Institutionella ägares förening, several of their members are already reporting the positions that they have taken on important issues as well as the considerations and discussions underlying their positions. Issues such as these are of interest to the majority of investors and the Institutionella ägares förening, suggests making this clearer in the written introduction to the Code.

*Deliberations and Conclusions*

The section of the Code on the ownership role and responsibility is aimed at both Swedish and foreign owners. However, in the opinion of the Code Group, differentiating between private and institutional owners is warranted. The latter manage capital, not for themselves, but for their clients. Therefore, these owners have a particular obligation to inform their clients of the principles followed in exercising the ownership role and how voting rights have been exercised in individual cases. This is reflected in the text of the original proposal, but some points have been clarified in the final text. However, in the opinion of the Code Group, going so far as to make the exercise of voting rights obligatory would involve too much interference in each owner's right to decide how the ownership role is to be exercised.

## 3 Rules for Corporate Governance

This section gives an account of the more important material comments and the Code Group's deliberations and conclusions on reviewing them. The discussion is organised around the same structure used in the original code proposal.

### 3.1 The Shareholders' Meeting

#### *Summary of the Comments*

Several respondents feel that the rules in this section of the code proposal call for too much detail and are too repetitious of what is already required under the Swedish Companies Act. Castellum believes that the costs of holding a shareholders' meeting will increase, that more time at meetings will be spent discussing formalities and that there will be less scope for discussing operations. An additional argument is that the shareholders' meeting will generally take longer and thus reduce the share-owning public's interest in participating.

As to individual rules, the Swedish Securities Dealers Association is of the opinion that six months' advance notification of the time and place of the meeting is too long and thus this time should be shortened. The Securities Council and the Confederation of Swedish Enterprise, among others, have also criticised the need for a company to publish the Council's statements before the annual general meeting. As far as the minutes of the annual general meeting are concerned, respondents have asked whether the proposed code means that the voters' list has to be made public – if so, this provision should be removed, according to the Stockholm Chamber of Commerce, the Swedish Insurance Federation, the Swedish Bankers' Association, the Swedish Securities Dealers

Association and Castellum, chiefly because it would mean making public the names of shareholders with minority holdings in the company. However, Hermes Pensions Management and Institutional Shareholder Services (ISS) would like the rule to be extended. They say that for all resolutions passed at shareholders' meetings, the company should always publish voting results as a percentage of issued capital share.

The Confederation of Swedish Enterprise, the Stockholm Chamber of Commerce, L E Lundbergföretagen, H&M, TurnIT and NAPF were critical of the proposal that the chair of the board of directors is not to be elected to chair the annual general meeting. They comment that this rule is contrary to existing practice and would add to companies' costs. According to NAPF, the chair of the board of directors is the only one suitable to chair the annual general meeting. In view of the complexity of this matter, the Swedish Bar Association is of the opinion that it would be an appropriate matter for legislation. Alecta does not comment on the proposal as such but suggests that the nomination committee submit proposals for a chair of the annual general meeting.

#### *Deliberations and Conclusions*

Overlap of the original proposal with the existing provisions of the Swedish Companies Act has been eliminated. In addition certain rules considered unnecessarily detailed have been excised, including the requirement for the requisite technical capacity for conducting votes at the annual general meetings. It is the opinion of the Code Group that there is no risk that the remaining rules will lead to annual general meetings at which formalities absorb more time and there is thus less opportunity to discuss the business of the company. The aim is quite the opposite. It is to create more substantive and informative meetings that are effective forums for shareholder governance of the company.

To link the announcement of the time and place for the annual general meeting to an existing public communication, the latest date for their announcement has been changed to coincide with the publication of the third quarter report. With a view to avoiding the problems associated with how the company is to handle confidential statements from the Securities Council and the ready availability of other Securities Council statements on the Council's

web site, the rule on including information on these statements in the notice of an annual general meeting and posting it on the company's web site has been scrapped. The rule that the company is to follow the law and self-regulation in the market has also been dropped in order not to give the impression that it is permissible to declare departures from the provisions of these regulatory regimes. In addition, in the rule on posting the minutes of the annual general meeting on the company's web site, the voting list has been exempted. The alternative of only exempting information on minority shareholders in the company was judged possibly to lead to costly extra work for the company since the voting list is not normally sortable by the size of the shareholding.

The rule that the person chairing the Board of Directors is not to be appointed to chair the annual general meeting emanated from the Code Group's general aim of limiting the occurrence of role conflict in corporate governance. The argument given against this rule is that in practice this role conflict is often limited and that it is valuable for the chair of the board of directors to be at the meeting and become known to shareholders, especially if the chair of the board is or represents a major shareholder in the company. The Code Group respects these views. Its aim is not to limit the role of major shareholders at the annual general meeting. However, it is the view of the Code Group that a clear division between the roles of the presenter and the recipient of the board's report of its governance duties, especially at the annual general meeting, is a valuable confidence-building measure.

To find a balance between these views, the Code Group has chosen to replace the rule prohibiting the chair of the board from chairing the annual general meeting with the rule that the nomination committee is to propose a chair at the annual general meeting. In that way, the preparation of the matter will have the desired structure and transparency. The Group would also like to point out that even though someone other than the chair of the board leads the deliberations at the annual general meeting, the chair of the board, owing in part to other rules in the Code, is expected to play a considerable role in the annual general meeting as spokesperson for the board. Nor is there anything to prevent the chair of the board from being given the opportunity to present his or her view of the business at the annual general meeting.

### 3.2 Appointing the Board and the Auditor

Under the code proposal, the company is to have a nomination committee that is either appointed directly by the annual general meeting or in accordance with a procedure decided by the meeting. The nomination committee is to nominate directors and auditors, recommend fees for their services and carry out some assessment of the board and the auditors prior to making proposals.

#### *Summary of the Comments*

Nordic Growth Market NGM and NAPF think that the nomination committee should be a committee of the board, not a body appointed by the owners. The Swedish Bar Association thinks that the role assigned the nomination committee and the importance of shoring up the rules with an appropriate system of sanctions will together lead to the need to consider whether the matter should be regulated by legislation rather than by self-regulation.

However, the majority of the respondents accept the appointment of a nomination committee by the owners, even though some think that the rules in the proposed code are excessively detailed. One objection put forward by several respondents is that the formulation of the rules, principally those providing that the nomination committee is to assess the board of directors and the auditors, risks changing the distribution of responsibilities among the governing bodies. Institutionella ägares förening för regleringsfrågor på aktiemarknaden emphasises the importance that the nomination not be seen as a “fifth governing body” that is to review and oversee the work of the board and the auditors. Their opinion is shared by the Swedish National Financial Management Authority, the Confederation of Swedish Enterprise, the Stockholm Chamber of Commerce, the Swedish Bankers’ Association, Styrelsepoolen, AktieTorget, the First, Second, Third and Fourth AP Funds, AMF Pension and L E Lundbergföretagen.

Institutionella ägares förening and First, Second and Third AP Funds, along with AMF Pension, think that the nomination committee should only work at the behest of the annual general meeting, which means, among other things, that it cannot take on tasks of its own. The Swedish Academy of Directors, the Swedish Shareholders’ Association and Private Property Forum point out

that the nomination committee is to work in the company's best interest on behalf of all shareholders, including minority shareholders, and that the members of the nomination committee are to be chosen by the annual general meeting. This last point is also made by the Institutional Shareholder Services (ISS). However, according to Alecta, the respective members of the nomination committee must have a clearly defined principal if the committee is to function effectively. This principal is usually a major shareholder in the company or a group of minority shareholders, who, through proxies or similar means, unite to co-operate in the work on nominations.

The Swedish Investment Fund Association, a number of institutional owners including Institutionella ägares förening and H&M stress that it is important for the nomination committee's responsibilities not to be interpreted in a way that makes it possible for nomination committee members to gain greater access to insider information than hitherto has been the case in work on nominations. According to AMF Pension, the insider issue should be given more attention in the Code.

As to the composition of the nomination committee, the Confederation of Swedish Enterprise, Styrelsepoolen and L E Lundbergföretagen think that shareholders who sit on the company's board of directors should be allowed to be members of the nomination committee so that owners are not forced to make a choice between being a member of the board or the nomination committee.

The tasks to be assigned the nomination committee have led to many comments. According to the Confederation of Swedish Enterprise and the Stockholm Chamber of Commerce, the nomination committee should not have chief responsibility for matters concerning the nomination of auditors and their fees – the nomination committee should only monitor and assess the process, while most of the work should rest with the audit committee. The Swedish Insurance Federation and the Swedish Bankers' Association think that the Code should only regulate the nomination committee's responsibility for nominating directors and auditors and their remuneration terms. It is the view of the Swedish Securities Dealers Association, Nordic Growth Market NGM and Castellum that the nomination committee should not consider any matters concerning the appointment of auditors. Björn Forslöv and Gabriel Thulin suggest that the annual general meeting appoint

separate nomination committees for procuring an auditor and nominating the board of directors.

Considerable criticism has been directed at the proposal that the nomination committee should conduct an evaluation of the board and the auditors as a basis for its proposals. Several respondents have interpreted the wording of the Code on this issue to mean that the nomination committee is to be a “fifth governing body” overseeing the board of directors and the auditors.

With respect to evaluating the board of directors, the Swedish National Financial Management Authority, the Confederation of Swedish Enterprise, the Swedish Insurance Federation, the Swedish Bankers’ Association, the Stockholm Stock Exchange, Aktie-Torget, Nordic Growth Market NGM, the First, Third and Fourth AP Fund, and TurnIT are of the opinion that it is sufficient for the board to present the result of its own internal evaluation to the nomination committee. An evaluation requires extensive competence and resources. Furthermore the proposal means that the same authority will both propose directors and then evaluate their own proposals. AMF Pension makes essentially the same criticism but thinks that the nomination committee should be allowed to conduct an in-depth evaluation if it considers it essential in order to make the requisite proposals.

The rule in the code proposal on the nomination committee’s evaluation of the auditors encountered additional criticism from the respondents. Many held the view that the nomination committee should not do any evaluation whatsoever of how the audit had been conducted; instead, this should rest with the audit committee or the board of directors. In contrast, FAR was of the opinion that the nomination committee, not the audit committee, should evaluate the auditors. According to FAR any other procedure would mean that the board (through the audit committee) would supervise the auditors, who, in turn, would have the task of reviewing the board’s management.

The Swedish Securities Dealers Association and the Fourth AP Fund think that the nomination committee should not prepare matters that concern incentives programmes since these require the decision of the shareholders’ meeting with a qualified majority and therefore need to be handled in some other way.

With respect to possible remuneration for the nomination committee, the Swedish National Financial Management Authority, the Swedish Bar Association and Nordic Growth

Market NGM think that this matter should not be regulated in the Code, while the Styrelsepoolen has the opposite opinion. It is the view of the Swedish Shareholders' Association that the members of the nomination committee should always have the right to remuneration for their work and decisions on such remuneration should be taken by the annual general meeting. In addition the nomination committee should have the option of getting help with their duties from external consultants and this should be stated in the Code.

As to when the composition of the nomination committee should be made public, the Swedish Bankers' Association points out that as a result of the code proposal, the prevailing practice in many companies – meaning that this information will be published in connection with the interim report for the third quarter – can no longer be followed. According to the Association, it should be sufficient to state in the Code that the announcement will be made in good time before the annual general meeting. Castellum shares this opinion.

### *Deliberations and Conclusions*

Special committees of the board for nominating candidates to positions on the board, or nomination committees, have their origins in the Anglo-American corporate governance system, in which the board of directors handles the nomination of directors. The requirement for the establishment of a nomination committee originated in response to the excessive influence senior executives were considered to have – through their inclusion in large numbers on the board of directors as so-called executive directors – on the composition of the board of directors, whose tasks include supervising these senior executives. Referral of this matter to a special committee composed solely of independent, non-executive directors disengages the nomination process from the operational management. However, under the Anglo-American model, it is still the practice for the work of nominating candidates to positions on the board of directors to be left to the board itself, even though it is done by the independent directors of the board. This arrangement reflects the more independent position relative to the annual general meeting that the board has under the Anglo-American system, compared with the situation in most European countries.

When the nomination committee system spread internationally, in most cases it was the Anglo-American model for the nomination committee that came into use, despite the differences in the corporate governance models in several of these countries. In Sweden, however, there has been a requirement from the beginning that nominations to the board of directors are to be made through a process governed by the owners.<sup>1</sup> Thus the nomination committee system came into practice, and most nomination committees in Swedish listed companies have been appointed either by the annual general meeting or directly by the owners. The explanation for this difference lies mainly in the important role played by the Swedish annual general meeting, a positive approach to owners' rights to exercise their ownership role in an active and responsible way, and the different ownership structure found in most Swedish listed companies compared with the case in the United Kingdom, for example. The nomination of directors by a committee of the board of directors is foreign to Swedish corporate governance tradition

Accordingly, the Code's proposal that the preparations leading to the election of the board by the annual general meeting take place through a process governed by the owners is basically a codification of prevailing practice in Sweden. The designation "valberedning" in Swedish, literally "election preparation committee", for the group responsible for this work instead of a more direct translation from the English term, "nomination committee" is aimed both at pointing out the group's purpose as a preparatory body for election matters and its independence from committees of the board. It is the opinion of the Code Group that the apprehension expressed by a number of respondents that such a body would contravene the Swedish Companies Act, constitute a "fifth governing body", or function as a supervisory body or board overseeing the board of directors is unfounded. The nomination committee is a body representing the owners tasked with preparing the decisions to be put before the annual general meeting on certain well-defined matters. It does not aim to change the responsibility structure in the Swedish corporate governance system in any respect. Rather it aims only to improve the quality of the annual general meeting's decision-making process for important appointments. The emergence of this body is actually one of the key elements in the evolution of modern corporate

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<sup>1</sup> See the ownership policy of the Swedish Shareholders' Association, 1993.

governance. Its primary aim is to ensure that directors are appointed to the board through a structured and transparent process, which, in turn, is designed to give all shareholders the opportunity to express their views on the matter and to provide a better basis for the annual general meeting to make well-founded decisions.

The Code Group believes that this matter has considerable relevance for all stock market companies. Therefore a nomination committee is prescribed for all companies. At the same time flexibility in the implementation of the requirement for a nomination committee is important in view of different companies' ownership structure and other circumstances. In that connection, one key issue has been how the nomination committee is to be appointed. One approach is to do this at the annual general meeting, when all shareholders have the opportunity to express their opinions and participate in the decision. In this way the nomination committee is firmly recognized as the legitimate representative of all shareholders collectively. Respondents criticising this approach have said that such a procedure determines the composition of the nomination committee an unnecessarily long time before it actually needs to start work. Consequently, this increases the risk that changes in the ownership structure will make it necessary to change the composition of the nomination committee and will prolong the period during which representatives of owners on the nomination committee may be subject to insider regulations, which then risks making it impossible for these owners to trade the company's shares during this period. The Code Group therefore recommends two alternative procedures. Either the annual general meeting should name members to the nomination committee or it should decide a procedure for appointing the nomination committee at a later time, stating the criteria to be followed in appointing the chair and members of the committee. In both instances, the decision is to include a procedure for replacing members, who, for some reason, resign from the nomination committee before its work is completed.

Concerning the composition of the nomination committee, the Code Group has agreed to respondents' wishes that major shareholders who sit on the board of directors, but do not chair it, also be allowed to sit on the nomination committee. This has been accomplished by permitting a minority of the nomination committee members to be directors. As in the earlier proposed

rules, this means that nomination committees consisting of three members may have only one director, but this can now be either the chair of the board or some other director. If there are to be two directors on the nomination committee, it must consist of at least five people.

However, the Code Group has not taken into account certain respondents' desire to postpone the date for announcing the composition of the nomination committee in the event that it is not appointed at the annual general meeting. The reason underpinning the Code requirement for nomination committees is to improve the nomination process leading to the election of directors. It is then of the utmost importance that the nomination committee be given sufficient time to do its work well. It is the opinion of the Code Group that the most relevant basis for deciding the latest time that a nomination committee must be formed is the date of the annual general meeting. Taking into account that the work should normally be completed no later than about one month before the annual general meeting, the Code Group continues to hold the opinion that the nomination committee is to be appointed and information on its composition announced no later than six months before the annual general meeting.

On the question of the nomination committee's preparations for the appointment of the board of directors, the final Code agrees in substance with the proposal. However, the wording that the nomination committee is to evaluate the board of directors has been deleted since it could be interpreted in an unintended way. Obviously the nomination committee, as part of its work, has to form an opinion of how well the composition of the board coincides with the company's needs as well as the board's effectiveness in discharging its duties. However, there is no need for a separate evaluation process in addition to the board's evaluation of its own work. Still it is advisable that the nomination committee acquaint itself with the result of this evaluation as part of the basis for its judgements. This is one of several points in a new rule that describes the nomination committee's tasks in general terms. In addition the rule now makes clear that for every member proposed, the nomination committee is to state whether the nominee is considered dependent or independent in relation to the company, the senior management and major shareholders. This task is the responsibility of the board of directors in the foreign

codes following the Anglo-American model for nomination committees. However, in a Swedish context this is an unfamiliar system and thus the task is instead given to the nomination committee.

As previously noted, the proposal that the nomination committee also prepare the decision on the auditors' appointment has met considerable criticism, although there are also comments in support of this proposal. The reason for the proposal is basically the same as that given for election to the board of directors: under Swedish law, the auditors, unlike the situation in the Anglo-American system, are appointed by the annual general meeting. Moreover, Sweden has a separate management audit, meaning that the auditors are also to review the board's (and the managing director's) management of the company. Given this task of the auditors, having the election of the auditors prepared by the same body – the board of directors – that will then be subject to review by the auditors is fundamentally wrong. FAR also points this out. This should instead be done by the owners, either directly or through a special preparatory body. The solution that presents itself immediately is to make use of the nomination committee appointed to prepare the nominations to the board. This has been done in some Swedish companies, although it is not a procedure that is in general use.

At the same time, the Code Group realises the problem with this solution. The nomination of auditors requires a nomination committee whose composition and competence differs in part from the requirements needed to nominate directors and often entails substantially more work than do nominations to the board. A nomination committee will therefore necessarily be highly dependent on the board, and especially its audit committee, if such a committee exists, to provide the basis for its work. The matter is further complicated by the fact that while election to the board is an annually recurring affair, the election of the auditor happens only every fourth year unless required in the interval. This means that in some years, the nomination committee will need to have a somewhat different composition and may need to do considerably more work than in other years in order to make effective preparations for the appointment of auditors.

One solution proposed by a respondent is to appoint a separate nomination committee when auditors are to be appointed. The Code Group has adopted this proposal and has proposed this

solution as an alternative to having the nomination committee for the election of directors perform this task. No special rules for such a nomination committee have been specified but the formal requirements for their composition, etc. are the same for both alternatives. In practice, the competence required of the nomination committee as well as the amount of work to be done and the time needed for the appointment of auditors differ from what is required to prepare for the election of directors, especially when new auditors are to be procured. The rule stating the information to be presented about the proposed auditor has been reworded more like a principle and is less detailed than the earlier proposal.

As previously mentioned, another task of the nomination committee is to submit proposals for someone to chair the annual general meeting (see section 3.1). The Code Group has also accepted the criticism made by some respondents of regulating the matter of preparing incentive programmes and therefore has not prescribed any rules on that subject.

Concerning remuneration for the nomination committee, the Code Group understands that there is sometimes a need for such remuneration, both to pay a fee to certain committee participants and to cover possible expenses associated with the nomination committee's work. In the opinion of the Code Group, this matter must have as its basis that an owner who has appointed a representative to the nomination committee is responsible for that representative's remuneration, and directors taking part in the nomination committee's work do not receive special remuneration for their participation. As to remuneration for other members, a rule in the Code might be warranted. However, owing to the legal uncertainty currently surrounding such remuneration – whether it could be considered some form of use of capital for the company and therefore might contravene the provisions of the Swedish Companies Act – the Code Group has refrained from regulating this matter. At the same time the Code Group would like to point out the urgency of regulating this matter by legislation as soon as possible.

### 3.3 The Board of Directors

As mentioned earlier (see section 1.4), several respondents have criticised what they believe to be excessively detailed regulation in the proposed code. This criticism has largely been directed at the section on the board of directors.

#### 3.3.1 The Role of the Board of Directors

##### *Summary of the Comments*

The Swedish Insurance Federation and several other respondents think that the proposed rules on the board's work go too far and there is some risk of changing what now appears to be practice. They also think that the enumeration given in the Code may risk being seen as an exhaustive regulation of the role of the board.

##### *Deliberations and Conclusions*

The section has been condensed and assembled as subpoints under one rule. The aim of the rule is to define in concentrated form some of the most fundamental tasks requiring a board's attention in order for it to be considered to have discharged its management duties well. With this new wording, the Code Group cannot detect any risk that the rule will be perceived as an exhaustive regulation of all the board's duties. The reason for the rule's inclusion is the Code Group's goal of producing a code that is reasonably comprehensive in describing good corporate governance.

A new rule on evaluating the board has been added to the section on the board's role. In the earlier code proposal, there was only an indirect referral to such an evaluation in the enumeration of the tasks of the chair of the board. It has therefore been deemed appropriate to insert in the section on the board a rule requiring that such an annual evaluation be held. The rule does not explicitly state how the evaluation is to be conducted or by whom – if the board itself evaluates its own work or if it is done by some external party – only that the evaluation is to be done through a systematic and structured process. However, one important aim of an evaluation of the board is to establish a basis for the board's own development. Therefore, it would be natural for the board to

participate in the evaluation, even when the evaluation is also conducted by an external party.

### 3.3.2 Size and Composition of the Board

#### *Summary of the Comments*

With respect to the rule on the composition of the board, there was criticism of the requirement that each member should be able to make independent judgements on the important issues facing the board. According to the Swedish Bar Association, the wording of the rules expresses a fundamental misunderstanding. The aim of a board of directors is to function as a collegium in which people with different kinds of knowledge and experience are to work in tandem for the company's good. The Confederation of Swedish Enterprise, the Swedish Securities Dealers Association and the Fourth AP Fund give similar reasons. The rule on aiming for an equal gender distribution does not draw criticism in itself, but some respondents think that the issue has received too prominent a place compared with other aspects of the requirement for diversity.

The Stockholm Stock Exchange would like the provisions stating which company employees can be members of the board to be harmonised with the Exchange's rules and regulations. Sten Dybeck believes that the managing director should not be allowed to be a member of the board.

The Code does not need to specify any precise limits on the number of directors elected by the annual general meeting, especially given the expanded role of the nomination committee, in the opinion of the Swedish Bar Association, the Stockholm Chamber of Commerce, the Swedish Insurance Federation, the Swedish Bankers' Association, the Swedish Securities Dealers Association, Nordic Growth Market NGM, the Third AP Fund, Alecta, H&M and Castellum. Moreover there has been extensive criticism of the requirement in the proposed code to submit special information before the election if a nominee for director has sat on the board for more than eight years or is over 70 years old. The Swedish Bar Association believes that age alone cannot be considered a reason for finding a person unsuitable to be a director. According to the Association, the directive of the Council of the European Union, Council Directive 2000/78/EC, on establishing a

general framework for equal treatment in employment and occupation also supports such a position. The directive is directed at terms of employment, not tenure on boards of directors, but nevertheless, in the opinion of the Association there is cause for taking into account the directive's general stance that all forms of discrimination, including age discrimination, are to be opposed. According to Alecta, there is no basis for assuming that a director's many years of service on the board or advanced age is normally a disadvantage for the company. To meet the need for renewal, Alecta would prefer that the Code used a less obtuse model than that proposed in the report. One alternative that should suit all companies, irrespective of the number of directors and other factors, would be for the nomination committee to specify its reasons when no renewal is proposed for the board.

With respect to the requirements for independent directors, the Stockholm Chamber of Commerce and the Stockholm Stock Exchange think that these requirements should be harmonised with the existing rules of the Stockholm Stock Exchange. The Swedish National Financial Management Authority, Hermes Pensions Management and Institutional Shareholder Services (ISS) point out that requiring only two members to be independent of major shareholders is not in line with the international trend and think that this should be changed to require that a majority be independent of the owners.

The Swedish Bar Association is of the opinion that the matter of independence would best be dealt with by a body of experts in their respective markets instead of in the Code. In this way it can be adapted to the special circumstances of each market. Stock exchanges and authorised marketplaces can apply independence criteria that differ from each other without causing difficulties. Instead such differences can be regarded as a matter of competition.

### *Deliberations and Conclusions*

The Code Group shares the opinion that directors should not be expected to have the ability to decide all matters independently, but rather a board of directors should be composed of a collegium of people with mutually complementary knowledge and experience. The wording that led to the other interpretations mentioned has therefore been removed.

The previous rule with an upper limit on the size of the board has been replaced with a rule on the board's size that is more in the form of a principle. The Code Group's aim in including the much-criticised rules requiring specification of the reasons for nominating directors for re-election who have served on the board for more than eight years or who are 70 years old or more was to make it easier for the nomination committee to effect a regular renewal of the board. Renewal has often proved difficult in practice. However, the Code Group shares in large measure the views criticising these rules. They have thus been scrapped and replaced with the requirement that the nomination committee is to give reason if no renewal of the board is proposed. One advantage of such a rule is that it does not single out individual directors. Instead it takes a more general approach stressing the need for renewal. However, the rule on length of service on the board resurfaces – though with a different time limit – as one of the criteria for a director's independence vis-à-vis the company. In line with the EU Commission's recommendation on directors' independence, etc.<sup>2</sup> this rule prescribes that directors who have served on the board for twelve years or more cannot be considered independent of the company.

On the issue of how many of the company's employees and which employees, if any, may serve on the board, the Code Group's earlier rule restricted board membership to senior management, and the rule stipulated that of this group only the managing director could be a member of the board. However, other employees in the company were permitted to serve on the board (among them, of course, any employees' representatives on the board). The Stockholm Stock Exchange's equivalent rule goes further in one respect by stipulating that no more than one director elected at the annual general meeting may be employed in the company's day-to-day operations. The company may decide if this board member is to be the managing director or some other person. For its part, the Code Group thinks that the underlying aim of such a rule should be to guarantee the board's integrity vis-à-vis operational management. Even though there is merit in having the same wording for the corresponding rules in both regulatory regimes to the extent possible, the Code Group considers the introduction of a provision that is as far-reaching as the Stockholm

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<sup>2</sup> EU Commission Recommendation on the role of non-executive or supervisory directors and on the committees of the (supervisory) board.

Stock Exchange's rule to be unwarranted. But the proposed rule opens the possibility that someone other than the managing director may be the (only) member of senior management to sit on the board.

Comments on the rules on directors' independence likewise expressed the wish for harmonisation with the corresponding rules of the Stockholm Stock Exchange. However, there is also an international development to take into account. The EU has recently issued a detailed recommendation in this area.<sup>3</sup> With respect to the board's independence in relation to the company and senior management, the requirement in the proposed code for a majority of independent directors is the same as that in the Stockholm Stock Exchange's rules, and it also is in line with the EU recommendation. However, the criteria for what may be considered to lead to insufficient independence differ to some extent. The EU recommendation is more far-reaching and detailed. The Code Group has elected to draw up a list of criteria based on the recommendation from the EU Commission.

The other issue raised about independence, which refers to directors' independence in relation to major shareholders, is one of the points on which the Swedish Code differs significantly from the majority of foreign codes. Foreign codes generally do not differentiate between independence in relation to the company/senior management and independence in relation to owners; a director who is not independent of both the former and the latter is not independent in the sense of these codes. In Sweden, however, the Stockholm Stock Exchange in its listing requirements defines independence in relation to (major) shareholders as a separate category. The rationale for this is the ownership structure commonly found in Swedish stock market companies, a structure with one or several principal owners along with a wider circle of smaller shareholders. This is combined with a generally positive view not only of the principal owners' active exercise of the ownership role but also the special responsibility that they take for the company, including, in many instances, making up the majority on the board of directors. That such an arrangement is not only accepted but also in many cases welcomed by the other shareholders may have to do with the express requirement of the Swedish Companies Act that the entire board –

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<sup>3</sup> See footnote 2.

thus even the representatives of the principal owners – is to take the interests of all shareholders into account in their management of the company.

Therefore there is no reason in principle for special representation for smaller shareholders on a Swedish board. Despite this, it has in practice proved appropriate to require that listed companies have at least one or more members of the board who do not have any link to the principal owners and therefore may be expected to pay special attention to the interests of a wider circle of shareholders. The Stockholm Stock Exchange has decided to require that there be two directors who are independent of the principal owners, where “principal owner” refers to shareholders who directly or indirectly own at least ten per cent of the shares or voting rights in the company.

The Code Group concurs with this opinion and therefore rejects the views of some foreign and other respondents favouring a requirement that the majority of the directors also be independent in relation to the major shareholders. Otherwise the aim has been to achieve as much harmonisation as possible with the EU Commission’s recommendation. Consequently the wording of this rule is not identical to the Stockholm Stock Exchange’s equivalent rule, even though the factual contents are on the whole the same.

### **3.3.3 The Directors**

#### *Summary of the Comments*

Some respondents, including the Confederation of Swedish Enterprise, the Stockholm Chamber of Commerce and the Swedish Securities Dealers Association, think that the code proposal’s rules on directors are superfluous since they largely state the obvious or repeat what already applies under the Swedish Companies Act.

#### *Deliberations and Conclusions*

Like the rules on the role of directors discussed earlier, these rules stem from the Code Group’s goal of producing a code that conveys a reasonably complete picture of good Swedish corporate governance. In particular the Group has wanted to emphasise the responsibility that rests with each individual director to ensure that

he or she sets aside the time, acquires the knowledge and experience, requests the necessary information and acts with the integrity that is required admirably to discharge his or her trustee-like duties for the company and its owners. It should be mentioned that the EU Commission's recommendation in this area treats this matter in a similar way. With this in view, the content of the earlier rules has largely been retained but it has been revised to make the director's obligation to take the initiative to acquire the information and knowledge necessary to discharge his or her duties more explicit. The previous rule on a director's obligation to act in the interest of the company and its shareholders, however, has been replaced by a rule providing that directors may not have so many other duties that they cannot devote the time and care necessary to discharge their duties in the company.

### 3.3.4 The Chair of the Board of Directors

#### *Summary of the Comments*

According to the Swedish Securities Dealers Association, the Fourth AP Fund, Nordstjernan and Castellum, the proposal that the annual general meeting elect the chair of the board of directors is an unnecessary rule that only leads to practical problems in the event that the board wishes to dismiss the chair. In that event, the proposal would make it necessary to summon an extraordinary shareholders' meeting. The Swedish Bar Association thinks that the provision should be dropped from the Code.

As to the proposal for special rules in the event that the outgoing managing director is nominated to chair the board, Styrelsepoolen, the Third AP Fund and NAPF are of the opinion that this rule should be worded as a prohibition. According to NAPF, there is convincing experience that it is inappropriate for the outgoing managing director to chair the board.

AktieTorget and TurnIT find it peculiar that the Code prescribes that the Board is to evaluate itself. According to AktieTorget, the task should fall to the company's auditors with the aid of external experts, if necessary.

*Deliberations and Conclusions*

Several respondents have questioned the proposed rule that the annual general meeting is to elect the chair of the board. The Code Group's motive for the rule is in brief as follows. Under the Swedish Companies Act, the chair of the board is to be elected either by the annual general meeting or by the board itself. Earlier views of the chair's role as *primus inter pares* – "first among equals" – have led to the practice that the directors would choose the chair of the board from amongst themselves. However, in the past few decades the chair's role has become much more important. The chair of the board has acquired an increasingly influential position with a special responsibility over and above that of other members, a position most recently manifested in the new rules on company organisation that were incorporated into the Swedish Companies Act in 1999. The increasing importance of the role of the chair is also evident at the time of the annual general meeting when, during the election of directors, it is usually clear who among the elected directors is to chair the board, even if the annual general meeting does not formally elect the chair.

The commonly practiced procedure thus stands in growing contrast to the actual procedure for appointing the chair. It would seem more natural for the election of the chair of the board, which is one of the most important decisions from the standpoint of corporate governance, to be taken up as a special item on the agenda of the annual general meeting. In that way, all shareholders would have the opportunity to ask questions and express their views on the matter. The rule is thus meant to be seen as part of the Code Group's effort to improve the structure and transparency of corporate governance and make the annual general meeting an effective forum for exercising the ownership role.

The Code Group has carefully considered the issue of whether the outgoing managing director can be nominated to chair the board immediately or soon after leaving the post of managing director. The Group is well aware of the problems that may arise with such an appointment and that certain other codes have restrictions against this arrangement, some more severe than others.<sup>4</sup> At the same time, the Code Group notes that in some

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<sup>4</sup> It should be noted that the British regulatory regime, which is sometimes cited on this issue, does not prohibit it, but it does require that such an arrangement is to be agreed with shareholders in advance and the reasons for doing so should be set out at the annual general meeting and in the next annual report.

cases this arrangement appears to have worked well. In these circumstances, the Code Group thinks that thus far there is no clear-cut experience pointing in either direction that would warrant a categorical rule on this issue.

In the rule on the duties of the chair of the board, an addition to the point on the responsibility to evaluate the board's work has been made as a consequence of what was said in section 3.2 to the effect that the nomination committee is to be informed of the result of this evaluation.

### **3.3.5 Board Procedures**

#### *Summary of the Comments*

Several respondents have criticised the proposed code's rules on attendance at board meetings as unnecessarily formalistic as well as contrary to the Swedish Companies Act to some extent. They therefore think these rules should be removed.

The Swedish Bankers' Association and the Swedish Securities Dealers Association criticised the proposal for an obligatory board secretary. The latter stressed in particular that there was no reason for Sweden to adopt this aspect of the American model. Moreover, in the opinion of several respondents, the wording of the provision stating that the secretary is to be "responsible for the proper conduct of the board's business" mistakenly gives the impression that the secretary would have a specific responsibility for this.

#### *Deliberations and Conclusions*

The Code Group thinks that the respondents' points about attendance rights at board meetings have merit. The rule dealing with attendance rights has thus been expunged. In addition the rule that the board is to meet to the extent necessary has been stricken because it is a needless interpretation of the provisions of the Swedish Companies Act.

In certain foreign codes, including the British, there is a requirement for an external board secretary, and in most large companies listed in Sweden, it is not the practice to charge the managing director or any other member of the board with taking the minutes at board meetings. The Code Group thinks that this

practice should be confirmed. The secretary certainly has no formal responsibility for the proper conduct of the board's business and thus the rule's wording has been changed to reflect that.

### **3.3.6 The Board of Directors and Financial Reporting**

#### *Summary of the Comments*

In the opinion of the Swedish Accounting Standards Board, the Annual Accounts Act (1995:1554) already provides that the company's financial reports are to be in accordance with good accounting practice and state the accounting standards on which they are based and these provisions should therefore not be repeated as a Code rule. The Confederation of Swedish Enterprise points out that financial information can be based on several regulatory regimes and suggests that the concept of the financial report be more clearly defined.

The requirement for a certification statement, that is, assurance by the board and the managing director that the annual report is correct, has drawn various comments. According to the Confederation of Swedish Enterprise, the Stockholm Chamber of Commerce, the Swedish Insurance Federation, the Swedish Bankers' Association, the Swedish Securities Dealers Association, the Stockholm Stock Exchange, the Fourth AP Fund and TurnIT, such a certification statement is unnecessary. However, FAR, the Supervisory Board of Public Accountants, the Swedish Accounting Standards Board, Svenska Revisorsamfundet SRS (Swedish Association of Auditors) and the Swedish Shareholders' Association think that it is of great value. Some respondents question the addition of "to the best of their knowledge", which they believe might be perceived as a disclaimer.

Respondents are more in accord that the rule requiring a special assurance from the company's director of finance should be expunged, whereas the Swedish Accounting Standards Board and Nordic Growth Market NGM, think it is justified. The main reason given by respondents opposing the rule is that it is foreign to Swedish corporate governance tradition to give an employee of the company the same responsibility given a body governing the company.

*Deliberations and Conclusions*

The rule requiring a company's financial reports to be in accordance with good accounting practice for a stock market company has been removed and replaced by introductory text for the section that is worded somewhat differently but that is intended to have the same meaning. The new rule in the Code says instead that it is to be clear from the annual and interim reports what reports are the formal financial reports, on what regulatory regime they are based and to what extent they have been audited or reviewed by the auditors. The international meaning of the concept "financial report" is explained in a footnote.

The proposal on the certification statement is based on the goal of making clear the various company bodies' responsibility area, a goal that is also in line with international developments. Several countries have already introduced requirements for such an assurance and it will be obligatory when the forthcoming transparency directive is incorporated into Swedish law. This directive, which is expected to be adopted shortly, includes a requirement for such an assurance in both the annual and the half-yearly reports. In addition to this, the EU has recently proposed clarification in the fourth and eighth company law directives of the requirement that Member States are to make explicit the board's collective responsibility for financial information.

Since the proposed certification statement makes clear terms that already apply, is in line with international developments and will soon be obligatory throughout the EU, the Code Group is of the opinion that such a certification statement deserves to be made part of Swedish stock market companies' annual reports. It should also be mentioned that regulations requiring a certification statement already exist, namely in the regulations of the Swedish Financial Supervisory Authority on listing particulars (3 kap. 6 § i FFFS 1995:21). To avoid ambiguity, it is the wording in this assurance that has been used in the Code.

However, the Code Group has chosen not to include the rule on assurance from the company's director of finance. This decision was due to the concern expressed by many respondents that the rule might give rise to uncertainty about the division of responsibility between the board and senior management. However, the Code Group would like to emphasise that the sole aim of the rule was to have a tool for the board to use in its work to

ensure the quality of the financial statements. There are, of course, other ways to do this. Furthermore it should be added here that under the new auditing standard RS 580, senior management is to issue a statement (in the form of a letter) to the auditors that includes an assurance like that proposed.

### **3.3.7 The Board's Internal Control and Internal Auditing**

#### *Summary of the Comments*

The proposal on the board's responsibility for the company's internal control was criticised by some respondents, especially the Fourth AP Fund and TurnIT, while FAR, the Supervisory Board of Public Accountants and the Institute of Internal Auditors support the rules. The Fourth AP Fund points out that the board is responsible for internal control and thinks that there is no need for special rules on how it is to be exercised. The Fund also thinks that the reasoning given for the internal audit requirements and reporting is too far-reaching and thus unnecessarily costly. FAR, however, is willing to co-operate with business organisations to produce guidelines on how companies are to interpret and apply the different regimes for internal control now in existence. Moreover FAR is prepared to help draw up proposals on how the board and the managing director's report on internal control should be designed.

Some respondents have asked for clarification of various aspects of the rules on internal control. The Institute of Internal Auditors thinks that there needs to be further clarification of the meaning of the concept of internal control and the Institute recommends using the term "intern styrning och kontrol" (internal governance and control) in Swedish for the English "internal control". The Institute of Internal Auditors also thinks that it should be made clearer that the responsibility for internal control rests solely with the managing director and the company's line organisation, not with the internal auditor.

*Deliberations and Conclusions*

The rules on internal control and internal audit aim to adapt the duties of the board in Swedish listed companies to an international standard now being developed. From an international perspective, the rules are important in understanding the Swedish management audit.

In spite of some respondents' wishes for additional guidance, the rules have been kept short since practice in this area needs time to develop and resources will have to be allocated. When good models showing how this reporting and review should be done have been developed, it will be time to come back with such clarifications. Here the Code Group would like to stress that the business community and FAR have a special responsibility for the development of practice in this area that is well adapted to Swedish conditions.

**3.3.8 The Board - Auditor Relationship***Summary of the Comments*

Several respondents, among them the Stockholm Stock Exchange, the Swedish Academy of Directors, the First and Fourth AP Funds, Alecta, L E Lundbergföretagen and TurnIT, are of the opinion that the Code should not require an obligatory audit committee. The majority of them think that it is up to the board to decide if any committees are to be established and that regulation should be made more flexible in this respect.

The Stockholm Stock Exchange has studied both the number of directors and the occurrence of board committees in the companies that it lists. This study shows that in more than a third of the companies, the board has four to six directors. The number of directors averaged 6.7 in June 2004 according to SIS Ownership Data Corp. This means that in a large number of companies, the majority of board members, or perhaps even the entire board, would form the audit committee. Another important factor is that directors who are not part of the audit committee do not have the same regular direct contact with the company's auditors as committee members have. The Stockholm Stock Exchange has noted that after the annual general meeting in the spring of 2004, a number of companies established audit committees consisting of

the entire board (with the exception of the managing director). At present less than a third of companies listed on the Stockholm Stock Exchange have set up an audit committee as called for under the proposed rule. The Stockholm Stock Exchange concludes from the preceding discussion that a general requirement for an audit committee does not reflect Swedish market practice and it is inappropriate to introduce such a requirement at the present time. It would lead to bureaucratisation and higher costs without necessarily improving corporate governance.

According to FAR and the Swedish Shareholders' Association, which, together with the Revisorsamfundet support the proposal, there should be some form of competency requirement for members of the audit committee; for example, a member should at least have the requisite skills to meet international circles' definition of "financial expert".

As to the audit committee's role, FAR, Revisorsnämnden and the Institute of Internal Auditors objected to having the audit committee evaluate the audit since the division of responsibility then is flawed – part of the board is to scrutinise the auditors who in turn are to oversee the board. According to these respondents, the annual general meeting or the nomination committee should review the effectiveness of the audit committee.

#### *Deliberations and Conclusions*

As to making an audit committee obligatory, the Code Group has the following considerations. Given that about a third of the companies listed on the Stockholm Stock Exchange already have an audit committee, the Code Group considers it urgent to develop a Swedish standard on the organisation and role of a model audit committee in Sweden. Such a standard should as far as possible be in accordance with the practice developed in a number of other countries.

The increasing interest in audit committees in recent years, chiefly among the larger listed companies, together with the proposed requirement in the revised EU directive on auditing for such a committee and in a recommendation from the EU Commission,<sup>5</sup> leads the Code Group to the conclusion that the rule should be retained. However, in light of the comments by

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<sup>5</sup> See footnote 2.

respondents, as well as the proposal in the revised auditing directive and the recommendation of the EU Commission, the main rule requiring an audit committee has been supplemented with an exception for companies having small boards whereby the entire board may perform the duties that would otherwise be done by the audit committee. When the board performs these duties, the requirement that the audit committee be independent must still be observed. This means that if the managing director is a member of the board, he or she may not participate in this work.

With respect to the views expressed by some respondents that competency in financial matters should be explicitly required of some members of the audit committee, a requirement also found in the proposal for the EU audit directive, the Code Group has reasoned in the following way. Such competency has not been made a requirement since it was considered superfluous. The nomination committee has to take this into account in preparing nominations for the board of directors and select candidates who are properly qualified.

Concerning respondents' criticism of having the audit committee assess the effectiveness of the audit, the Code Group would like to point out that the rule was proposed because senior management has until now often been responsible for assessing the effectiveness of the audit even though this should formally be the task of the annual general meeting. However, in practice the annual general meeting does not have the means of making this assessment. Several respondents have also been doubtful that the nomination committee has either the time or the competence for this task.

The rule is thus based on the practical reality prevailing in the majority of stock market companies and aims at underlining that it is the audit committee, not senior management, that is to assess the auditors' effectiveness. The result of this assessment then forms part of the basis for the nomination committee's work proposing auditors for presentation at the annual general meeting. In addition, as previously mentioned, the audit committee is to assist the nomination committee in drawing up proposals for auditors and their fees.

### 3.4 Senior Management

#### *Summary of the Comments*

The introductory rules on the tasks of the managing director and the board's appointment of the managing director were criticised by the Confederation of Swedish Enterprise, AktieTorget, H&M, Castellum and others. They maintain that these rules overlap regulations found in the Swedish Companies Act. The Swedish Securities Dealers Association thinks that limiting the managing director's professional commitments outside the company only in relation to membership on boards of directors in other stock market companies constitutes an arbitrary restriction that does not serve any purpose. According to the Association it would be better to have a provision that says that the board, or the chair on behalf of the board, has to approve any external professional commitments of the managing director, in which case the requirement does not need to be limited to duties in other stock market companies. Styrelsepoolen thinks that the rule should be dropped.

With respect to the rules on remuneration committees, the Stockholm Stock Exchange, the Swedish Academy of Directors, the First and Fourth AP Funds, Alecta, L E Lundbergföretagen and H&M think that such a committee should not be mandatory. According to the Fourth AP Fund and others, a more flexible approach permitting different solutions for different types of companies would be preferable. For example, in smaller companies or companies with a small board, requiring a remuneration committee is usually not reasonable. In the Fourth AP Fund's opinion, prescribing that the board has to organise its work in several committees should not be an end in itself. The Skandia affair appears to be an unfortunate case in which the board lost track of the overall picture owing to inadequate communication between the remuneration committee and the rest of the board.

The proposed code means that the annual general meeting is to decide remuneration terms for senior management, which will then be implemented by the board and the managing director. The Confederation of Swedish Enterprise, the Swedish Bar Association, the Stockholm Chamber of Commerce, the Swedish Securities Dealers Association, the Swedish Insurance Federation, the Swedish Bankers' Association, the First and the Fourth AP Funds, Alecta and Castellum are of the opinion that it is sufficient that

information on remuneration terms be presented at the annual general meeting and that a decision by the annual general meeting reduces flexibility on remuneration issues. According to Nordstjernan, the provision should be expunged as it is more a symptom of the times than an understanding of how the board is to discharge its duties.

### *Deliberations and Conclusions*

The rules and the associated comments in this section that most appear to overlap with regulations in the Swedish Companies Act have been scrapped. However, the rule on the managing director's obligation to furnish the board with the requisite information on which to base this work is being retained even though this rule can also be viewed as entailing an interpretation of the Swedish Companies Act to some degree. By retaining it, the Code Group has elected to emphasise the particularly important role that the managing director plays in enabling the board to discharge its duties effectively and make well-founded decisions.

The restriction of the managing director's professional commitments in other stock market companies previously specified has been changed to the rule that all important professional commitments outside the company are to be approved by the board.

There are two recommendations from the EU Commission about how remuneration terms for senior management are to be prepared, decided and communicated.<sup>6</sup> In addition the Code Group has learned that legislative work on these matters is in progress at the Ministry of Justice. The exact form of this legislation and the date that it will come into force have not been decided; therefore, the Code Group has decided to keep the rules on these matters in the Code. It will then fall to the future code management body to modify the rules in view of any legislation that may be introduced.

The rules have been modified in some respects in view of respondents' comments and in general harmonised with the EU Commission's recommendations in this area. The rule on remuneration committees, like that for audit committees, has been amended to permit smaller boards in plenary session to discharge

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<sup>6</sup> EU Commission Draft recommendation on fostering an appropriate regime for the remuneration of directors of listed companies, 2004-10-06, and the EU Commission Draft recommendation on the role of non-executive or supervisory directors and on the committees of the (supervisory) board, 2004-10-06.

the remuneration committee's duties, provided that directors who are part of senior management do not participate. However, the Code Group has not changed its opinion that pursuant to the requirements on structure and transparency in preparing these matters, they should not be delegated to a single individual on the board.

The rule on decisions on remuneration for the managing director and the rest of senior management has been expunged since there is some overlap with statutory requirements. The remaining rules in the section have been harmonised with the EU-recommendations on the subject.

The rule that the annual general meeting is to approve remuneration terms and other terms of employment for senior management attracted the most attention from respondents commenting on remuneration issues. All respondents who commented on the matter prefer that the rule be dropped. The Code Group notes, however, that one of the EU recommendations<sup>7</sup> states that this matter is to be made an explicit item on the agenda of the annual general meeting and submitted to the meeting for a vote. This vote may be either advisory or mandatory. However, advisory votes at annual general meetings are foreign to Swedish corporate governance tradition. Therefore the substance of the rule has been kept as before for the most part, but its enumeration in point form of the terms to be included has been revised to improve harmonisation with the EU recommendation on remuneration for directors.

### 3.5 Auditors

#### *Summary of the Comments*

Some respondents criticised the rule requiring the company's auditors to provide a separate report reviewing the board's report on internal control. The Stockholm Stock Exchange thinks that such a report might give the impression that there has been extensive annual auditing of how internal control has been functioning. Such auditing may be justified in some companies but it is excessive and costly for the average company. It should be left to

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<sup>7</sup> EU Commission Recommendation on fostering an appropriate regime for the remuneration of directors of listed companies, 2004-10-06.

the board to decide how far the company needs to go in this respect. In Castellum's opinion, the rule asks too much in the way of reports and audit reviews; the auditors' report is sufficient. Likewise the Fourth AP Fund questions the need for such a review. FAR has taken the opposite position and offers to be responsible for providing guidance for this review.

Respondents took two opposing positions on reviewing interim reports. According to FAR, the auditors should review all interim reports on the grounds that these reports have taken on increasing importance for market operation and directly affect the stock market price. Conducting such reviews would better meet interested parties' expectations that all financial information is quality assured. The benefits therefore exceed the costs. This is especially important in 2005 owing to the introduction of International Financial Reporting Standards (IFRS) – otherwise trading in a company's shares can continue as long as one year before the auditors have the opportunity to call attention to possible accounting errors. However, the Confederation of Swedish Enterprise and the Stockholm Stock Exchange both think that the rule requiring a review of interim reports should be dropped. According to the Stockholm Stock Exchange, the matter of reviewing interim reports has been examined on several occasions when the Exchange's listing agreements were being reviewed. The conclusion has repeatedly been that the positive effect of introducing the rule is insignificant compared with the extra costs it would involve for the companies. Requiring such a rule would also delay the publication of the report. According to the Exchange, the issue has been discussed at the EU level but has been expunged from the transparency directive expected to be adopted shortly.

### *Deliberations and Conclusions*

Since the section in the code proposal on the auditors' duties contained only a few material rules, the section has been deleted and the rules have been merged with the sections on financial reporting and internal audit. As part of the proposal's revision, the earlier rule that prohibited issuing instructions to the auditor that reduce the possibility of conducting the audit in accordance with good auditing practice has been scrapped since it does not add anything important to existing regulations.

The Code Group has come to the following conclusions about the auditor's review of the board's report on internal control. In recent years developments in both Sweden and abroad have indicated the importance of good internal control in a company as well as the need for the board to monitor senior management's performance in this area. The Code's requirement for a report from the board on how internal control is organised and functioning helps to ensure good internal control. However, the value of the board's report is substantially reduced if the company's auditor does not review it. Developments in other countries and the views of international investors clearly demonstrate this. It is the Code Group's opinion that the criticism of the provision requiring a review is, in part, misdirected. The reason for requiring a separate board report on internal control and its review by the auditors is that this board report is not included in the statutory audit. Attaching these documents to the formal annual report clarifies the meaning of the reports while allowing time for practice to develop. The cost of this review would be modest in small listed companies whose business activities are not complex. Thus the requirement for the auditors to review the report has been retained. The rule is now clearer as it expressly states that there should be a review, not a full audit.

The Code Group has carefully considered respondents' views on having the auditor review at least one interim report and has reassessed the pros and cons of introducing such a requirement. The Group concludes that the demand for quality assurance for stock market companies' financial reports will gradually increase and considers the reliability of these reports to be fundamental for market confidence. Moreover there are more actors in the market – quite legitimately – with short-term shareholdings as their principal business activity. An interval of one year between reports reviewed by the auditors therefore appears more and more unsatisfactory. The Code Group's overall assessment therefore, in contrast to the opinion of the Stockholm Stock Exchange thus far, is that the time now is ripe for introducing a general requirement for auditors to review at least one interim report. The Group is well aware of the advantages of requiring the review of the same interim report in all stock market companies but considers it more important that companies have the option of choosing between the second and third quarter reports, depending on what suits each company best. Therefore the rule stands unchanged.

### 3.6 Information on Corporate Governance

Under the code proposal, the company is to attach a corporate governance report to its annual report. In this corporate governance report, the company is to state how the company is applying the Code and mention possible departures from individual rules in the Code. In addition, the company is to have timely corporate governance information on its web site.

#### *Summary of the Comments*

According to the Fourth AP Fund, the corporate governance report, especially the requirement to keep it regularly updated on the company's web site, involves a significant increase in listed companies' administrative burden. The report is presumed to be included in the annual report but it does not constitute part of the legal annual report. At the same time, several items that appear in the legal annual report, for example, in the note on remuneration, are repeated in the corporate governance report or in other places in the printed annual report, for example, in the presentation of directors. According to the Fourth AP Fund, the issues of duplication of information and who is to be responsible for the information need to be examined. The Fund doubts whether the form for the corporate governance report should be prescribed and wonders if it would not be better for companies themselves to be responsible for compiling this information.

The requirement for constantly updated information on the company's web site is excessively time-consuming and costly, particularly for smaller stock market companies, according to the Confederation of Swedish Enterprise and the Swedish Bankers' Association. Similar views were expressed by the Swedish Securities Dealers Association, which also thinks that there is a great risk that companies will overlook updating their web sites. Instead they should be obliged to state the source of the information so that visitors to the web site can themselves check how current the information is. According to the Association, the company should state its policy on updating the web site in the report.

As with the interim reports, the respondents have different views on the need for the auditor to review the corporate governance report. FAR and Aktiespararna think that the auditors

should review the report; according to FAR, they should review that part dealing with auditable information. However, such a statement must be presented in a separate report, not in the auditors' report. According to the Stockholm Stock Exchange, reviewing the corporate governance report could not be justified financially.

### *Deliberations and Conclusions*

The range of information to be included in the corporate governance report has been reduced to some extent compared with the earlier proposal and the requirement for regular updating of the information on the web site has been changed to require that the information be current. In addition the previous instructions in individual rules on information to be presented in the corporate governance report have mostly been removed. Instead the rules on the content of the corporate governance report have been put in a separate concluding rule section. This makes the Code clearer.

The Code Group's aim in introducing a corporate governance report is not to require companies to provide an extensive new administrative report. The aim is a concise and clear presentation in a section in the printed annual report or in a separate report surveying all relevant information on corporate governance. A large part of the material to be included can now be found in other parts of the company's annual report. Duplication of information should be avoided as much as possible. In those instances in which corporate governance information is already included in the annual report, it is sufficient to refer in the corporate governance report to the place in the annual report containing the information.

The Code Group has decided not to require auditors to review the corporate governance report; however, the report should make clear whether or not there has been such a review. Under the earlier proposal, the board's report on internal control (see section 3.3.7) was to constitute part of the corporate governance report. Since the report on internal control is to be reviewed by the company's auditors as discussed in section 3.5 but there is no such requirement for the corporate governance report in its entirety, it was decided that it was clearer to make the report on internal control a separate report alongside the corporate governance report. As the rule text states, both reports are to be attached to the company's (legal) annual report or issued as separate reports.

## 4 When will the Code come into effect?

In the foreword to the code proposal, the Code Group stated that its aim was for the Code to come into effect in 2005. The proposal did not contain any further discussion on implementing the Code. A few respondents, however, did raise the matter.

### *Summary of the Comments*

The Seventh AP Fund thinks that implementation of the Code is to begin as soon as possible, while the Swedish Association of Exchange-Listed Companies, the Confederation of Swedish Enterprise and the Swedish Securities Dealers Association think that for practical reasons the earliest that this can be done is July 1, 2005. According to the Swedish Securities Dealers Association, it will obviously take some time for Swedish companies to adapt to the Code. Being able to apply the Code by the beginning of 2005 is out of the question in the opinion of the Association. In addition certain conditions are dependent on actions by the shareholders' meeting; therefore, it would be doubtful that everything that needs to be done could be accomplished by the 2005 annual general meeting. Being forced to arrange an extra shareholders' meeting later in the year for this purpose cannot easily be justified according to the Swedish Securities Dealers Association. Requiring a number of clarifications on departures for this reason also appears unfortunate. Clarifications on departures owing to non-compliance with the Code will therefore be required in connection with the annual general meetings in 2006 at the earliest.

Another matter raised by the Swedish Association of Exchange-Listed Companies, the Confederation of Swedish Enterprise, the Swedish Securities Dealers Association and the Fourth AP Fund is whether the Code will apply to all stock market companies from the beginning or whether there will be a transition period for small

companies. Several respondents prefer some form of gradual introduction, starting with the large listed companies.

### *Deliberations and Conclusions*

From December 16, 2004, when the Code Group submits its report to the Minister for Justice and to the organisations and bodies in the business community that along with the Commission on Business Confidence gave the original Code Group its mandate, there will be a Swedish code of corporate governance. How, by whom and at what rate the Code then starts to be applied lies outside the Code Group's authority to decide. However, it is the opinion of the Code Group that it is urgent that it be done as soon as it is practical to do so, and in section 1.3 a gradual implementation was recommended, with certain companies listed on the Stockholm Stock Exchange obliged to apply the Code in the first stage. Then in a few years, coverage should be broadened to all companies listed on the Exchange.

It is the Stockholm Stock Exchange that after negotiations with listed companies will fix the date on which the companies concerned are to start applying the Code. The same applies to other marketplaces and company owners. To give companies that are initially to apply the Code reasonable time to prepare, the Code Group thinks that mid-2005 is a suitable time to begin applying the Code. Hence 2006 will be the first full year when the Code is to be applied and departures from Code rules will have to be reported and explained. However, there is nothing to stop any companies from applying the Code in whole or in part at an earlier date should they wish to do so.

# Committee Directive



**Swedish Code of Corporate Governance**

**Dir.  
2004:132**

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Decision taken at the Cabinet meeting 30 September 2004.

## Summary of Directive

A committee has been appointed with instructions to review the comments received in response to the circulation of the report *Swedish Code of Corporate Governance, A Proposal by the Code Group* (SOU 2004:46). The committee is to make the revisions to the corporate governance code proposed in the report that it deems appropriate in view of the respondents' comments. The committee's work is to lead to a revised code of corporate governance.

The proposed corporate governance code is intended to be an instrument for self-regulation in the business community. In its work the committee is therefore to take into consideration the Code's relation to and demarcation vis-à-vis legislation in force and other regulatory regimes in the area of corporate governance. The committee is also to take into consideration the work in progress on this subject in the Government Offices.

## Background

### *Introduction*

Public confidence in the business sector, like confidence between various actors in the business community, is of fundamental importance to the economy and the willingness to invest. It affects companies' ability to attract capital and thus people's employment opportunities, savings and pensions.

In recent years, confidence in Swedish business has been a focus of public debate. Against this background, the Government on

September 5, 2002 authorised the Prime Minister to appoint a commission to examine the need for measures to strengthen confidence in the Swedish business community (SB 2002:01, dir. 2002:115). The Commission, which adopted the name, the Commission on Business Confidence, was instructed to:

- establish a dialogue with business owners and representatives on the current status of business confidence,
- examine whether there appeared to be any events that have shaken confidence in Swedish business and, if so, review them,
- describe the business community's own efforts aimed at creating confidence,
- analyse the need for measures to strengthen and ensure confidence in Swedish business,
- study relevant international experience,
- determine whether legislation, public regulation and regulatory regimes in the business community need to be changed, paying special attention to the consumers' perspective, and
- propose those measures deemed necessary.

The Commission on Business Confidence issued the report, *Näringslivet och förtroendet* (Business and Confidence) (SOU 2004:47). The Commission's work touched on several matters of corporate governance. The Commission consequently presented a number of proposals to amend legislation on these matters. One of the proposals was that the decisions on remuneration terms for the managing director and other members of senior management in public stock market companies should be made by the shareholders' meeting.

The report of the Commission on Business Confidence was circulated for comments. Comments were to be submitted no later than September 30, 2004.

#### *A Swedish Code of Corporate Governance*

In addition to considering legislative changes, the Commission on Business Confidence also looked at the relationship between legislation and self-regulation in corporate governance.

The Commission noted that legislation – when compared with self-regulation – has certain clear advantages. It carries more weight because it is based on a democratic process, there is greater legal

certainty in its application, and through its specification of minimum levels, it has a norm-building function. The disadvantages cited for legislation are that it requires a slow decision-making process, that the high standard of proof required under the rule of law can make application difficult and that as a result of the requirement for comprehensive norm building using minimum levels, the regulations may establish requirements that are too low. The Commission noted that self-regulation is a more flexible instrument than legislation, but that self-regulation may have less legitimacy among a broader public. The sanctions associated with self-regulatory systems are also usually weaker than sanctions based on legal regulations. For self-regulation to be effective, there must be strong public pressure to follow the rules.

The Commission on Business Confidence came to the conclusion in its report that legislative regulation and self-regulation complement each other and that both forms of regulation need to be developed to promote confidence in business. The Commission observed that the Swedish legal tradition with legislative regulation aimed at prescribing the basic rules but leaving much of its interpretation to the application of the law is worth preserving. Therefore the Commission's goal was to propose as little additional legislative regulation as possible and instead give priority to self-regulation where appropriate.

With respect to the forms of self-regulation, the Commission noted that in recent years several countries have developed national codes of corporate governance, one example being the British Combined Code. However, there is not yet any equivalent comprehensive and broadly accepted self-regulation in Sweden. With the aim of improving the quality of Swedish corporate governance and thus strengthening Swedish businesses' efficiency and dynamism, the Commission took the initiative of forming a special working group called the Code Group with the mandate of drawing up a Swedish code of corporate governance in October 2003. The Code Group was established in co-operation with the business community and, in addition to members of the Commission, was composed of members appointed by a number of bodies and organisations in the business community.

In April 2004, the Code Group presented the results of its work in the report *Swedish Code of Corporate Governance* (SOU 2004:46). The report contains a proposal for a special regulatory regime, a code, of corporate governance. According to

the report, the Code is to provide the necessary conditions for the active exercise of the ownership role, create a sound balance of power and a clear distribution of responsibility among the various governing bodies, and promote more transparency. The Code's rules set more ambitious goals than do current legal requirements. The Code is primarily written for Swedish limited liability companies listed on Swedish exchanges but according to the Code Group, most of it will also be relevant for other categories of companies with a diverse ownership or large public interest. There is no intention to incorporate the Code's rules into legislation. Nor do the rules aim to be obligatory. Instead the application of the Code is to be voluntary and in accordance with the model "comply or explain". This means that a company that is applying the Code, but departs from certain of its rules, is to give an explanation for the departure. It is then up to the market to decide if the explanation is acceptable. If it is not acceptable, then it is likely that the company will suffer negative publicity and the capital markets will have less confidence in it.

### Reasons for Review

#### *Future Management of the Code*

The proposal for a Swedish code of corporate governance aims at achieving a more coherent regulatory regime in the area of corporate governance based on self-regulation. This means that the rules in the Code should not be made law. It also means that the matter of continued responsibility for the Code and its development should preferably be solved before application of the Code begins. The Commission in its report, *Näringslivet och förtroendet*, has proposed that the Code should henceforth be managed by a non-profit association with the central government and a number of organisations and bodies in the private business sector as members. With the circulation of the report for comments, consultees have been given the opportunity to express their views on the matter. The matter of the future management of the Code will be discussed in another context.

### *Respondents' Views*

Another question is about the Code's material contents. As previously mentioned, the Code is the result of co-operation between a government commission and representatives of the business community. However, many of those affected by the regulatory regime naturally could not participate in shaping the Code in detail. Since one condition for the Code to be observed is that it have the express support of the business community, it is important for as many as possible to be given a chance to submit their views on the Code. Therefore, with respect to the Code's content, both the Commission and the Code Group have stated that the Code should be subject to scrutiny by a broad circle of consultees and other interested parties before the final text of the Code is decided. Consequently the Government Offices have circulated the report *Swedish Code of Corporate Governance*, to a large number of authorities, organisations and companies.

Since the Code is intended to become part of self-regulation in the business community, it is natural that the business community should participate in writing the Code. It is thus not certain that the comments received on the proposed code will be prepared in the customary manner by the Government Offices. Instead development of the Code from now on should be done through co-operation between the central government and the business community. For this purpose a special committee is being appointed.

### **Directive**

The committee is to handle the comments received on the Code. The comments will be discussed in the committee's report.

In addition the committee is to analyse the respondents' views. Based on this analysis, the committee is to consider whether the Code needs to be modified or reformulated. The committee is also to consider the public debate on the Code. The committee is to account for the positions it has taken.

It is important that the Code's relation to other normative systems is clear. In its work the committee is therefore to take into consideration the Code's relation to and limitations in light of legislation in force and other regulatory regimes in the area of

corporate governance. In doing so, the committee is to give careful consideration to the Code's demarcation vis-à-vis these regulatory regimes. In this connection the Code's rules must from the start be compatible with existing laws in the area and the Code's rules must not provide any room for circumventing legal requirements. The committee is also to take into consideration the work in progress in the Government Offices.

Furthermore the committee is to keep informed of the work underway in the EU and the OECD on corporate governance.

The committee is to make amendments to the Code in view of the comments received or that it finds appropriate for other reasons. The committee is to present a revised version of the Code of Corporate Governance in its report.

The report is to be submitted no later than December 17, 2004.

(Ministry of Justice)

# List of Consultees

Ackordcentralen  
Aktiefrämjandet  
Aktiemarknadsbolagens förening  
Aktiemarknadsnämnden  
AktieTorget AB  
Alecta pensionsförsäkring, ömsesidigt  
AMF Pension  
Andra AP-fonden  
Bokföringsnämnden  
Bokhållaren i Torskabäck, Torulf Jönsson  
Brottsförebyggande rådet  
Castellum AB  
Coop Norden  
Datainspektionen  
Delegationen för utländska investeringar i Sverige  
Ekobrottsmyndigheten  
Ekonomistyrningsverket  
FAR  
Finansbolagens Förening  
Finansinspektionen  
Fjärde AP-fonden  
Folksam  
Fondbolagens Förening  
Forsslöw, Björn och Thulin, Gabriel  
Fristående Sparbankers Riksförbund  
Företagarförbundet  
Företagarnas Riksorganisation  
Företagsekonomiska institutionen, Uppsala universitet  
Första AP-fonden  
H & M Hennes & Mauritz AB  
Handelshögskolan i Stockholm

Hermes Pensions Management Limited  
Industriförvaltnings AB Kinnevik  
Industrivärden AB  
Institutional Shareholder Services (ISS)  
Institutionella ägares förening för regleringsfrågor på  
aktiemarknaden  
Internrevisorernas Förening  
Investment AB Latour  
Investment AB Öresund  
Investor AB  
Josefsson, Lars-Göran  
Juridiska fakultetsnämnden vid Göteborgs universitet  
Kammarrätten i Sundsvall  
Kommerskollegium  
Konsumenternas Bank- och Finansbyrå  
Konsumenternas försäkringsbyrå  
L E Lundbergföretagen AB  
Landsorganisationen i Sverige  
Landstingsförbundet  
Lantbrukarnas Riksförbund LRF  
Livförsäkringsaktiebolaget Skandia  
Länsstyrelsen i Stockholms län  
Nordic Growth Market NGM AB  
Nordic Investor Services  
Nordstjernen AB  
Note AB, Sten Dybeck  
Näringslivets Börskommitté  
Näringslivets Nämnd för Regelgranskning  
Palmgren, Per-Olof  
Patent- och registreringsverket/Bolagsverket  
Ratos AB  
Redovisningsrådet  
Revisorsnämnden  
Rikspolisstyrelsen  
Riksåklagaren  
Sjunde AP-fonden  
Sjätte AP-fonden  
Skatteverket  
Statskontoret  
Stena AB  
Stockholms Handelskammare

Stockholmsbörsen  
StyrelseAkademien  
Styrelsepoolen  
Svea hovrätt  
Svensk Handel  
Svenska Bankföreningen  
Svenska Fondhandlareföreningen  
Svenska Handelskammarförbundet  
Svenska kommunförbundet  
Svenska Revisorssamfundet SRS  
Svenskt Näringsliv  
Sveriges Advokatsamfund  
Sveriges Akademikers Centralorganisation  
Sveriges Aktiesparares Riksförbund  
Sveriges Försäkringsförbund  
Sveriges Informationsförening  
Sveriges Redovisningskonsulters Förbund SRF  
Sveriges riksbank  
The National Association of Pension Funds Limited (NAPF)  
Tjänstemännens Centralorganisation  
Tredje AP-fonden  
TurnIT AB  
Verket för näringslivsutveckling NUTEK  
VPC  
Ägarfrämjandet

# Swedish Code of Corporate Governance

*Stockholm 2005*

This report is on sale in Stockholm at Fritzes Bookshop, which supplies Swedish official government reports (SOU) and departmental series (Ds) and also on behalf of the Government Offices, Office for Administrative Affairs, arranges for them to be circulated to the competent parties for comments.

Address: Fritzes, Customer Service  
SE-106 47 Stockholm  
Sweden

Telefax: 08 690 91 91 (national)  
+46 8 690 91 91 (international)

Telephone: 08 690 91 90 (national)  
+46 8 690 91 90 (international)

E-mail: [order.fritzes@nj.se](mailto:order.fritzes@nj.se)  
Internet: [www.fritzes.se](http://www.fritzes.se)

Printed by Elanders Gotab AB  
Stockholm 2005

ISBN 91-38-22308-2  
ISSN 0375-250X

# Foreword

This document marks the first time that a comprehensive code of corporate governance likely to achieve general acceptance in the business community, has been issued in Sweden. The Code is based on the Swedish Companies Act [aktiebolagslagen (1975:1385)] and the tradition of self-regulation, which from an international perspective, is relatively well-advanced in a number of respects. Nevertheless, it is the opinion of the Code Group that corporate governance in Swedish companies needs to be improved. Like a number of other countries, Sweden has suffered several corporate scandals that have aroused considerable attention and caused legitimate criticism. A large majority of the Swedish people currently own shares, directly or indirectly. How companies listed on the stock exchange are managed affects them materially. Our society is ultimately dependent on a business sector that is dynamic, creates value and enjoys public confidence.

In recent years corporate governance issues have attracted increasing attention both in Sweden and abroad. In various countries important initiatives have been taken by many companies, by governments and at an international level. Many countries, not least in Europe, have established corporate governance codes in the past few years. There are many indications that the field of corporate governance will continue to evolve rapidly. Against this background, the Code Group believes that it is important that Sweden also adopt a corporate governance code. The aim is to improve corporate governance through better self-regulation. In future, members of the business community are to oversee and develop the Code. The Code Group has had ambitious goals. The aim is not only to codify what is currently considered good practice for corporate governance in Swedish companies, but also to advance practice in certain areas.

Work on the Code has taken place in two stages. In the first stage, the work was conducted by a working group composed of nine members, three of whom were appointed by the Commis-

sion on Business Confidence (Förtroendekommissionen) and the remaining six by a number of bodies and organisations in the business sector. The work was carried out between October 2003 and April 2004. The proposals put forward by the working group were then widely circulated for comments and extensive public debate. In the second stage, the work was done from October to December 2004 by the Code Group, a new committee appointed by the Government, composed mainly of the same members who made up the previous working group. Its task was to make the necessary changes to the original code proposal, based on the views expressed in the comments received and from the public debate, and to present a final corporate governance code that could be applied sometime in 2005.

The Code Group was composed of Erik Åsbrink, chairman, Rune Brandinger, Claes Dahlbäck, Karin Forseke, Lars-Erik Forsgårdh, Eva Halvarsson, Arne Mårtensson, Marianne Nivert, Lars Otterbeck, Henrik Paulsson, Bengt Rydén and Patrik Tigerschiöld. Rolf Skog, Lars Thalén and Per Thorell participated in the Group as experts. Secretary of the Group was Per Lekvall and Björn Kristiansson was assistant secretary.

The bodies and organisations in the business community that, together with the central government, were the primary sponsors are FAR (the institute for the accountancy profession in Sweden), the Swedish Investment Fund Association (Fondbolagens Förening), the Swedish Industry and Commerce Stock Exchange Committee (Näringslivets Börskommitté), the Stockholm Stock Exchange (Stockholmsbörsen), the Stockholm Chamber of Commerce (Stockholms Handelskammare), the Swedish Bankers' Association (Svenska Bankföreningen), the Swedish Securities Dealers Association (Svenska Fondhandlareföreningen), the Confederation of Swedish Enterprise (Svenskt Näringsliv), the Swedish Shareholders' Association (Sveriges Aktiesparares Riksförbund) and the Swedish Insurance Federation (Sveriges Försäkringsförbund).

Stockholm, December 16, 2004

Erik Åsbrink  
Chairman of the Code Group

# Contents

<b>I. Introduction</b>	5
1 A Swedish Code of Corporate Governance	5
1.1 The Code's Aim and Its Basic Principles	5
1.2 Target Group	6
1.3 Comply or Explain	7
1.4 Form and Content of the Code	7
<b>2 Swedish Corporate Governance in an International Context</b>	9
<b>II. The Ownership Role and Responsibility</b>	11
<b>III. Rules for Corporate Governance</b>	12
1 The Shareholders' Meeting	12
1.1 Notice of Shareholders' Meeting	12
1.2 Distance Participation	12
1.3 Board, Management and Auditor Attendance	12
1.4 Conducting the Shareholders' Meeting	12
2 Appointment of the Board and Auditors	13
2.1 Nomination Committee	13
2.2 Appointment of the Board of Directors	14
2.3 Appointment of Auditors	15
3 The Board of Directors	16
3.1 Tasks	16
3.2 Size and Composition of the Board	16
3.3 Directors	17
3.4 The Chair of the Board of Directors	18
3.5 Board Procedures	19
3.6 Financial Reporting	19
3.7 Internal Control and Internal Auditing	20
3.8 Accounting and Auditing Issues	20
4 Company Management	21
4.1 The Managing Director's Duties	21

4.2 Senior Management Remuneration . . . . . 21

5 Information on Corporate Governance . . . . . 22

5.1 Corporate Governance Report. . . . . 22

5.2 Report on Internal Controls . . . . . 23

5.3 Information on the Company’s Web Site . . . . . 23

# I. Introduction

Corporate governance deals with the management of companies with a view to meeting the owners' required return on invested capital and thus it contributes to economic growth and efficiency.

In the past few decades corporate governance has evolved rapidly. As a result, many countries have introduced more or less voluntary compilations of rules, or codes, of corporate governance. International bodies such as the OECD and the EU have also drawn up guidelines for corporate governance. With the introduction of this Code, Sweden will have an equivalent body of rules.

## 1 A Swedish Code of Corporate Governance

Sweden has not had a comprehensive code until now, but that does not imply a lack of regulations and guidelines in this area. The Swedish Companies Act forms the basis of Swedish corporate governance. After revision and updating in the past decade, this act regulates several matters that in other countries are dealt with in codes and similar regulatory regimes. Since the Swedish Shareholders' Association published Sweden's first ownership policy in 1993, the majority of larger Swedish institutional owners have drawn up their own guidelines on how the ownership role should be exercised. The self-regulating bodies in the business community have continued to incorporate a number of regulations on corporate governance into their regulatory systems. In 2003 the Swedish Academy of Directors issued its Guidelines for Good Board Practice, the first comprehensive description of good practice for boards of directors of Swedish companies.

Thus the current introduction of a Swedish code of corporate governance is not due to insufficient regulation. However, the Commission on Business Confidence and many in the business community share the opinion that there is a need for a more comprehensive compilation of what constitutes good Swedish

practice in corporate governance, starting from existing regulations and custom, but also improving on current practice in some respects.

## **1.1 The Code's Aim and Its Basic Principles**

The general aim of the Code is to help improve corporate governance in Swedish companies. Even though the Code is directed primarily at stock market companies, sound corporate governance in these companies will serve as an example and a model for other types of companies. In the opinion of the Code Group this, in turn, is likely to improve efficiency and competitiveness in the business sector. It is also likely to bolster confidence in the Swedish capital market and the confidence of Swedish society generally in the way in which business functions.

A second aim of the Code is to enhance understanding and confidence in Swedish corporate governance on the part of foreign investors and other actors in the international capital markets, with a view to promoting the Swedish business sector's access to foreign risk capital on favourable terms.

Some key principles underlying the Code Group's work developing the Code have been:

- to create good conditions for shareholders to exercise the ownership role actively and responsibly,
- to create a sound balance of power between the owners, the board of directors and the executive management to enable shareholders to assert their interests vis-à-vis company management,
- to create a clear division of roles and responsibilities between the various governing and supervisory bodies,
- to uphold in practice the principle of equal treatment of shareholders as found in the Swedish Companies Act , and
- to create as much transparency as possible towards shareholders, the capital market and society in general.

## 1.2 Target Group

Corporate governance issues are most important in companies with broad public ownership. The Code is therefore aimed primarily at stock market companies, that is, companies listed on a stock exchange or other authorised marketplace. However, for the most part, other types of companies with a diverse ownership or public interest – for example, other listed companies, co-operatives, state- and municipally owned companies and mutual insurance companies – as well as many privately owned companies, especially those preparing to go public, should also be able to put these rules into practice.

Good corporate governance is important in all stock market companies irrespective of their size. However, an ambitious regulatory regime may be too demanding for smaller companies to implement in its entirety. Thus the aim has been to provide enough flexibility for simplification where warranted without lowering the goal of creating an internationally respected code for the larger listed companies. Moreover, under the principle of comply or explain (see text that follows), it should also be acceptable for smaller companies to report a larger number of departures from the rules than do larger companies.

The Code Group's premise is that to begin with, companies listed on the Stockholm Stock Exchange should be obliged to apply the Code in the near future. There may be reasons for considering a step-by-step implementation, beginning with the largest and most qualified companies. The Group recommends as a first step introducing the Code in companies listed on the A-list and in the larger companies listed on the O-list. After a few years of experience gained applying the Code, coverage should be broadened to include all companies listed on the stock exchange. There are advantages to proceeding in this manner. The experience gained in the practical application of the Code can form the basis of possible modifications in connection with the Code's extension to more firms. Furthermore, the larger companies will develop systems and routines for applying the Code in a cost-effective manner. Smaller companies can then make use of any relevant parts of such systems and routines. The larger stock market companies will thus bear much of the initial costs of establishing appropriate systems and routines for applying the Code.

Implementing the Code is also recommended for companies listed on stock markets other than the Stockholm Stock Exchange as well as for many unlisted companies. The Code Group is convinced that application of the Code will come to be viewed as a sign of quality that an increasing number of marketplaces and companies will consider important to acquire.

For a company listed on stock exchanges or marketplaces in several countries, its legal domicile should decide which country's code it is to follow. The Swedish Code is thus intended for Swedish limited liability companies. If a Swedish company, because it is listed on a foreign stock exchange having mandatory rules that contravene the Swedish Code, is obliged to depart from certain rules in the Swedish Code, this obligation should generally constitute a valid reason for a departure under the principle of comply or explain.

### **1.3 Comply or Explain**

The Code is intended to form part of self-regulation in the Swedish business sector. It is based on the principle "comply or explain", which the majority of foreign codes follow. Under this principle a company following the Code may depart from individual rules; however, in that event, it must provide an explanation stating the reasons for each departure reported. Thus applying the Code does not mean that every rule must always be observed and departing from one or more individual rules does not constitute a breach of the Code. Rather, in some instances deviating from a rule that is not suitable for an individual company may signify good corporate governance. The reason for the deviation is what is important.

With this principle, the Code's goals could be set higher than would have been possible had the rules been compulsory. With the issuance of obligatory rules, requirements must be kept at the level at which every company can reasonably be expected to comply at all times, a sort of lowest common denominator that suits everyone. Instead, with the principle of comply or explain, requirements can be set at a level expected to lead to good corporate governance while sufficient flexibility is created to take differences between companies into account. Consequently the Code provides a picture of what may generally be considered to

constitute good corporate governance, even though individual companies may have reason to depart from certain rules.

One important question is what requirements should be established for explaining the reasons for any departures and who is to decide whether or not these requirements have been met. The Code contains no rules on how departures are to be explained. The Code Group's position is that it is a matter for the board of directors in individual companies to decide. However, in some instances, it may be difficult to issue a well-founded statement explaining the reasons for a departure. For example, the shareholders' meeting could make decisions that depart from the rules of the Code without giving any reasons for these departures to the board of directors. In such instances it should be considered sufficient for the board of directors to refer to the decision of the shareholders' meeting in the corporate governance report without specifying a reason.

The Code Group is not proposing that any particular authority pass judgment on the acceptability of reasons for departing from a rule. In the case of stock market companies, it is assumed that the market, in the form of investors and other actors, will ultimately decide whether or not an explanation is acceptable. Companies that depart from the rules in the Code without giving any reasonable explanation for the divergence risk suffering a loss of confidence on the part of the capital markets, which may then have a negative impact on the company's value. For other types of companies, it is chiefly the owners' responsibility to judge the reasons for reported departures.

#### **1.4 Form and Content of the Code**

The Code deals with the decision-making system used by the shareholders to govern the company, both directly and indirectly. This is expressed in a number of rules on the organisation and working methods of individual company governance bodies and the interaction between these bodies. In addition there are guidelines on reporting to shareholders, the capital market and the general public.

The Code's rules represent an addition mainly to the provisions in the Swedish Companies Act on a company's organisation, but also to the relatively extensive self-regulation that exists in the

area of corporate governance. Such self-regulation is found in the listing requirements and listing agreements of the Stockholm Stock Exchange, Nordic Growth Market NGM and AktieTorget; the rules of the Swedish Industry and Commerce Stock Exchange Committee; statements by the Securities Council; and FAR's rules and regulations.

The provisions of the Swedish Companies Act are not repeated in the Code's rules, but the comments to provisions in the Code do refer to them to facilitate reader comprehension where appropriate. Likewise, an aim in writing the Code has been to avoid an overlap with self-regulation. Here, however, certain exceptions have been made, primarily to take into account EU recommendations recently issued in this area, for example, the criteria for directors' independence and certain remuneration issues. Furthermore, the Code, as previously mentioned, is also intended for other types of companies in addition to those covered by the rules for stock market companies.

The Code does not deal with issues concerning the audit function and the way in which the stock market works. Nor does it deal with relations with customers, employees or the general public. These matters have not been considered part of corporate governance. The rules in the Code are designed to provide guidance to companies. This means that in most cases, rules are intended for the board of directors, but certain rules are meant for the shareholders' meeting, the auditors or the managing director. Thus under the Code, these bodies are assumed to be part of the company.

Two types of text are used in the Code:

- The rules in the Code are shown in normal type. Departures from the rules are to be reported and explained under the principle, *comply or explain*. To avoid introducing uncertainty about the requirements for observing individual rules, "is to" has been used throughout. However, this does not mean that the rule is compulsory. As previously stated, it is possible to deviate from individual rules without breaching the Code as a whole.
- The introductory text of main sections and some sub-sections is shown in italics. The aim of this introductory text is to provide a clear statement of the fundamental approach forming

the basis for the rules that follow. It does not constitute rules and there is no requirement to report or explain departures from what is stated there.

In addition there are comments on certain rules in the footnotes. Their aim is to explain, when necessary, the intended meaning of the rule or to put the rule in a context that makes it easier to understand. Such text is not part of the rule per se, so companies do not need to act on this text in any particular way in the event of any departures.

## **2 Swedish Corporate Governance in an International Context**

In its main features, the Swedish model of corporate governance is fundamentally the same as the models of corporate governance applied in most industrialised countries. At the same time, owing in part to different ownership structures and traditions and to legislation and other regulations in the area, there are certain distinctive features that have to be taken into account in drawing up a Swedish code of corporate governance. Some of these distinctive features are reported in point form below, principally in relation to the Anglo-American model that has come to dominate international developments in the area.

- The ownership structure of the companies listed on the Swedish stock market differs substantially from that in such countries as the United Kingdom and the United States. While the majority of listed companies in these countries present a very dispersed ownership picture, it is common for one or a few major owners to dominate ownership in Swedish listed companies (as in most continental European countries). These owners often actively exercise their ownership role and take a particular responsibility for the company in various ways such as taking part in the board of directors.
- The Swedish Companies Act provides for a hierarchical governance structure in which senior governance bodies can issue directives to subordinate bodies or even take over their decision-making authority. A Swedish shareholders' meeting is sovereign in deciding all the company's affairs, including, where appropriate, issuing express instructions to the board of directors and the managing director on the company's man-

agement. However, such directives are rarely issued in listed companies.

- As a rule, each shareholder in attendance at the shareholders' meeting has the right to vote for all shares owned. The articles of association may provide that each shareholder may only vote for a certain number of shares, but in practice, such restrictions on voting rights are very uncommon. In addition the Swedish Companies Act permits shares with differentiated voting rights. However, the maximum ratio is 1:10. About half of the Swedish stock market companies currently have such differentiation in voting rights. Swedish limited liability companies do not have the right to issue nonvoting shares.
- The decisions of the shareholders' meeting are generally taken with a simple majority of the votes cast. However, to protect minority shareholders, especially shareholders with reduced voting rights, requirements have been drawn up for qualified majorities of both votes and capital for major decisions. In addition there is a general rule for the protection of minority shareholders prescribing that the shareholders' meeting may not make a decision that might give undue advantage to some shareholders at the expense of the company or other shareholders.
- Under the law, the shareholders' meeting elects the company's board of directors and decides on discharge of liability for members of the board and the managing director. The meeting's decision on the appointment of the board of directors is therefore normally prepared under a process controlled by the owners.
- Under Swedish law, the company's auditors are also appointed by the shareholders' meeting. The auditor's task is not only to examine the company's annual accounts and accounting practices, but also to review the management of the company by the board of directors and the managing director. Thus one important aim of the auditors is to satisfy the owners' requirements to control the board of directors and the managing director. Today the auditors are also considered to have the aim of protecting the interests of other stakeholders in the company, such as employees, creditors and capital market actors.

- The Swedish model's basic structure for corporate governance by the owners lies somewhere between the Anglo-American one-tier model and the continental European two-tier model. A Swedish limited liability company must have a board of directors and a managing director. The board is responsible for the company's organisation and the management of the company's affairs. The extensive decision-making authority thus assigned the board is limited primarily by the exclusive decision-making powers of the shareholders' meeting in certain matters and the meeting's right to issue instructions to the board.
- One distinctive feature when compared with the Anglo-American model is the structure of the board of directors. The Swedish Companies Act requires a certain degree of separation in the exercise of the executive and management authorities. Thus in public limited liability companies<sup>1</sup>, the same person cannot be the managing director and chair the board. Further in most listed companies in Sweden, no members of the board come from the company's senior management other than the managing director. Thus, other than the managing director and the employee representatives on the board (see text that follows), the board of directors in a Swedish company listed on the stock exchange is normally composed exclusively of non-executive directors. Persons with links to major shareholders usually constitute a majority on the board and only a few directors are independent of the major shareholders.
- Employees have the right to representation on the board of Swedish companies. In a few words, in companies with at least 25 employees, employees have the right to appoint two representatives to the board of directors and two deputy members, while in companies with activities in several lines of business and a minimum of 1,000 employees, they have the right to appoint three representatives and two deputies. However,

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<sup>1</sup> The Swedish Companies Act distinguishes between private and public limited liability companies, the main difference being that the latter can promote the sale of its shares to broad circles of potential investors and list the shares for trading on a stock exchange or other organised marketplace, steps that a private company is not allowed to take. Hence all listed companies are by definition public limited liability companies.

employee representatives may never constitute a majority on the board.

- A managing director appointed by the board of directors is mandatory in limited liability companies. The managing director is responsible for the company's day-to-day management but, unlike the two-tier model, the Swedish managing director is subordinate to the board. The managing director is obliged, within the bounds defined by the law and the articles of association of the company, to follow instructions from the board on how routine management measures are to be handled or decided. The board may also decide on matters that are part of the day-to-day management but must not intervene in the day-to-day operations to such an extent that the managing director in reality may no longer be considered to have that position. The managing director is also obliged to follow any directives that the shareholders' meeting might issue.

## II. The Ownership Role and Responsibility

A dynamic and competitive business sector requires a well-functioning capital market through which to channel savings in the form of loan capital and risk capital to companies for investment.

Owners that take responsibility for the firm's development are an important element of an efficient market economy. Shareholders provide risk capital to the economy, but they also contribute to the efficiency and innovative capacity of individual firms and the business sector generally by exercising influence via the shareholders' meeting as well as by buying and selling shares.

A dynamic business sector requires a diverse ownership with different investment aims, time horizons and risk propensity. A well-functioning market for controlling shareholdings and the acquisition of companies also promotes a dynamic business sector.

Shareholders with large holdings in stock market companies should make use of the opportunity provided by the shareholders' meeting to exercise influence in the company, among other things, through the election of the company's board of directors, and should have a well thought-out policy on how to exercise the ownership role in the company. Shareholders' active participation in the shareholders' meeting promotes a sound balance of power between owners, the board of directors and senior management.

Shareholders with large holdings in stock market companies have a special responsibility not to abuse their power to the detriment of the company or other shareholders. Shareholders with a minority interest have a responsibility not to abuse their minority rights to the detriment of the company or other shareholders.

Institutional owners, such as pension funds, life insurance companies, mutual funds, investment companies and others, should make their ownership policy public and so inform investors of their investment philosophy and the principles followed in exer-

cising the voting rights attached to the shares. In particular, information should be made available showing how the underlying interests of investors are looked after. Where appropriate, institutional owners should also provide information about potential conflicts of interest that might affect the exercise of the ownership function. Investors should have easy access to information on how the voting rights have been exercised in each instance as well as the underlying considerations.

# III. Rules for Corporate Governance<sup>2</sup>

## 1 The Shareholders' Meeting

*Shareholders' influence in the company is exercised at the shareholders' meeting, which is the company's highest decision-making body. To create the best possible conditions for the active exercise of the ownership role, the shareholders' meeting should be conducted in such a manner that as high a percentage as possible of the total number of shares and votes can be represented at the meeting and that active participation on the part of current shareholders in the discussions and decision making is facilitated.*

### 1.1 Notice of Shareholders' Meeting

- 1.1.1 As soon as the board of directors has decided to hold an extraordinary shareholders' meeting, but no later than the time of the third quarter report, the company is to announce the time and location of the meeting. The information is to be posted to the company's web site at the same time that it is announced.
- 1.1.2 Before issuing a notice of an annual general meeting, the company is to provide timely information on its web site on the shareholders' right to have a matter considered at the meeting and the time when such a request must reach the company in order to guarantee its inclusion in the notice of meeting. When possible, similar procedures are to be followed before an extraordinary shareholders' meeting.

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<sup>2</sup> The rules in the Code are shown in normal type. The aim of the introductory text to individual sections shown in italics is to provide a clear statement of the fundamental approach forming the basis for the rules that follow. The aim of the footnotes is to comment on or to explain, when necessary, the intended meaning of the rule or to put it in a context that makes it easier to understand.

- 1.1.3 Shareholders are to be given the opportunity to register to attend the shareholders' meeting in several ways, among them registration by e-mail or on the company's web site.

## **1.2 Distance Participation**

- 1.2.1 At each shareholders' meeting, the company is to provide shareholders with the option of following or participating in the meeting from another location in the country or abroad with the help of modern communications technology if it is warranted by the ownership structure and financially feasible.

## **1.3 Board, Management and Auditor Attendance**

- 1.3.1 At shareholders' meetings, a quorum of the board is to be present. If possible, the entire board is to be present at the annual general meeting. The chair of the board of directors, the managing director and, if necessary, other company managers are to be present at the meeting. At least one of the company's auditors is to be present at the annual general meeting.
- 1.3.2 If proposals for decisions on certain items have been prepared by a committee of the board, the chair or another member of the committee is to be present at the shareholders' meeting and describe and give cause for the proposals on behalf of the board.

## **1.4 Conducting the Shareholders' Meeting**

- 1.4.1 The company's nomination committee is to recommend a candidate to chair the annual general meeting. The recommendation is to be included in the notice of the shareholders' meeting and presented by the nomination committee at the meeting.
- 1.4.2 A shareholder, or a representative of a shareholder, who is neither a director nor an employee of the company, is to be chosen to verify the minutes of the shareholders' meeting.
- 1.4.3 The shareholders' meeting is to be conducted in Swedish and the material presented is to be in Swedish. The company is to consider whether the proceedings are to be simultaneously translated in whole or in part and whether the material presented by the company is to be translated into any other lan-

guage as warranted by the ownership structure and if financially feasible.

- 1.4.4 The chair of the shareholders' meeting is to see that the shareholders are given sufficient opportunity to exercise their statutory right to ask questions at the meeting as well as to comment on the items on the agenda, recommend changes and additions to the proposals presented, and submit new proposals in accordance with statutory provisions before the meeting comes to a decision.
- 1.4.5 The minutes from the last annual general meeting and any subsequent extraordinary shareholders' meeting are to be posted on the company's web site. It is not necessary to report the register of voters from the meeting. The protocol is also to be translated from Swedish into any other language as warranted by the ownership structure.

## **2 Appointment of the Board and Auditors**

*The decisions of the shareholders' meeting on the appointment of the board of directors and auditors should be prepared by a structured and transparent process governed by the shareholders. It should provide all shareholders with the opportunity to express their views on proposals and present proposals on the issues at hand. It should also provide a good basis for making well-founded decisions.*

### **2.1 Nomination Committee**

*The nomination committee is a body of the shareholders' meeting that prepares the decisions on appointments to be taken by shareholders at the shareholders' meeting. The committee's aim is to provide a sound basis for the meetings' consideration of these matters.*

- 2.1.1 The company is to have a nomination committee that represents the company's shareholders. The shareholders' meeting is to appoint members of the nomination committee or to specify how they are to be appointed. The decision is to include procedures for replacing members of the nomination committee who resign before its work is concluded, if necessary.

If members of the nomination committee are not appointed by the shareholders' meeting, the meeting is to decide on the criteria to be used in appointing the chair and members of the nomination committee.

- 2.1.2 The nomination committee is to have at least three members. The majority of the members of the nomination committee are not to be members of the board of directors. The managing director or other company managers are not to be members of the nomination committee. The chair of the board of directors or another board member is not to chair the nomination committee.<sup>3</sup>
- 2.1.3 The company is to announce the names of members of the nomination committee at least six months before the annual general meeting. If a member represents a particular owner, that owner's name is to be stated. The replacement of a member of the nomination committee is to be made public and the corresponding information about the new member is to be provided. The information is to be found on the company's web site, which is also to specify how shareholders may submit recommendations to the nomination committee.

## **2.2 Appointment of the Board of Directors**

- 2.2.1 The nomination committee is to make recommendations for the chair and other members of the board and recommendations on the division of board fees among the chair and other directors and on remuneration for committee work, if any.
- 2.2.2 As the basis for its recommendations, the nomination committee is to:
- assess the extent to which the current board meets the demands that will be made of the board as a consequence of the company's current position and future direction, among other things, by studying the result of the evaluation made of the board,
  - establish requirements profiles for the new member or members who, according to this assessment, should be recruited, and

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<sup>3</sup> The nomination committee should not include any members who represent any of the company's competitors.

- execute a systematic procedure for the recruitment of directors, with due consideration for shareholders' recommendations.<sup>4</sup>

2.2.3 The nomination committee's recommendations are to be presented in the notice of the shareholders' meeting and on the company's web site. The following information for persons nominated for election or re-election to the board is to be posted on the company's web site in connection with the issuance of the notice of the shareholders' meeting:

- age and principal education and work experience,
- any work performed for the company and significant professional commitments outside the company,
- his or her own holdings of shares and other financial instruments in the company or such holdings by related natural or legal persons,
- if, according to the nomination committee, the board member is considered to be independent of the company and its senior management, as well as of major shareholders in the company,
- on re-election, the year that the member was first elected to the board, and
- other information that may be important to shareholders in assessing the proposed member's competence and independence.

A report on how the nomination committee has conducted its work is to be posted on the company's web site.

2.2.4 At the shareholders' meeting, the nomination committee is to present and give reasons for its recommendations. It is to specify its reasons if its recommendations do not include any new nominees. In addition, the nomination committee is to submit a report on how it has conducted its work.

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<sup>4</sup> In light of the information that may need to be given to members of the nomination committee, the company may have reason to reconsider its confidentiality agreements aimed at eliminating the risk that such information is divulged to owners on a selective basis.

- 2.2.5 Persons recommended for election to the board are to be present at the meeting, if possible, so that they can introduce themselves and answer questions from shareholders.
- 2.2.6 The shareholders' meeting is to decide on directors' fees and all other remuneration for board work and the allocation to the chair and other members of the board and remuneration for committee work, if any.
- 2.2.7 Directors are not to participate in share or share-price incentive schemes aimed at company management or other employees. If such a programme is intended for the board alone, the shareholders' meeting is to decide the programme. The decision is to specify the maximum number of instruments that may be issued, the main terms of the allocation, the main terms and principles to be observed when estimating the value of the instrument and the latest date that the instrument can be issued or transferred to the board member.

Even though the managing director is a member of the board, he or she may participate in incentive schemes intended for management and employees.

### **2.3 Appointment of Auditors**

- 2.3.1 Recommendations on the appointment of auditors are to be made by the company's nomination committee or a nomination committee appointed especially for that purpose. When a separate nomination committee is appointed, the regulations in 2.1 and this section apply.
- 2.3.2 The nomination committee is to make recommendations on the selection of auditors as well as on audit fees. These recommendations are to be included in the notice of the shareholders' meeting and posted on the company's web site.
- 2.3.3 In connection with the issuance of the notice of the shareholders' meeting, information that may be of importance to shareholders in assessing the competence and independence of the proposed auditors is to be posted on the company's web site. The information is to show what services other than auditing were provided by the proposed auditor to the company over the past three years and, in the event of re-election, the year that the auditor was first appointed and the length of the engagement. A report on how the nomination

committee has conducted its work is to be posted on the company's web site.

- 2.3.4 At the shareholders' meeting, the nomination committee is to present and give reasons for its recommendations and submit a report on how it has conducted its work.
- 2.3.5 The proposed auditor is to be present at the meeting to be introduced and answer questions from the shareholders.

### **3 The Board of Directors**

#### **3.1 Tasks**

*The principal task of the board of directors is to manage the company's affairs in such a way as to satisfy the owners that their interests in a good long-term return on capital are being met in the best possible way.*

- 3.1.1 To meet its obligations to the company's owners, the board of directors is to pay particular attention to:
- establishing the overall goals for the company and deciding the company's strategy for achieving these goals,
  - evaluate the company's operative management on an ongoing basis and, if necessary, appoint or dismiss the managing director,
  - ensure that there is an effective system for follow-up and control of the company's operations and financial position vis-à-vis the established goals,
  - ensure that the company's external communications are open, objective and appropriate for the target audience,
  - ensure that there is a satisfactory process for monitoring the company's compliance with laws and other regulations that apply to the company's operations, and
  - ensure that the necessary guidelines governing the company's ethical conduct are established.
- 3.1.2 The board is to ensure that there is an annual evaluation of its work and that this evaluation employs a systematic and structured process.

## **3.2 Size and Composition of the Board**

*The board should have a size and composition that enable it to embrace the various qualifications and experience needed and to meet the independence criteria required to manage the company's affairs effectively and independently. The renewal of the board should be paced with due consideration for the development of the company's operations as well as for the need for continuity in the work of the board.*

- 3.2.1 With the company's operations, phase of development, and other conditions taken into consideration, the board is to have an appropriate composition, exhibiting diversity and breadth in the directors' qualifications, experience and background. An equal gender distribution on the board is to be an aim.
- 3.2.2 The board is not to exceed the size that will allow it to employ simple and effective working methods. There are to be no deputies to the directors chosen by the shareholders' meeting.
- 3.2.3 No more than one person from senior management may be a member of the board.
- 3.2.4 The majority of the directors elected by the shareholders' meeting are to be independent of the company and its management. A director is not to be considered independent if he or she:
- is the managing director, or in the preceding five years has been the managing director, of the company or associated enterprises,
  - is employed, or in the preceding three years has been employed, in the company or an associated enterprise,
  - receives significant remuneration for advice or services in addition to board work from the company or an associated enterprise or from someone in the senior management,
  - has, or in recent years has had, extensive business ties or other extensive financial dealings with the company or an associated enterprise, in his or her capacity as customer, supplier or part-owner, either personally or as part of the senior management or the board or by being a major partner in another enterprise having such a business relationship with the company,

- is, or in the past three years has been, a partner or employee of the audit firm currently or then auditing the company or an associated enterprise,
- is part of senior management in another enterprise having a director who is part of senior management in the company,
- has been a member of the board for more than twelve years, or
- is a close relative or family associate of someone in the senior management or of some other person as provided in the preceding clauses, if this person's direct or indirect dealings with the company are sufficiently extensive and important that the director is not considered independent.

An associated enterprise refers to an enterprise in which the company, directly or indirectly, holds at least 10 per cent of the shares or participation or the votes or a financial interest that gives the right to at least 10 per cent of the return of this enterprise. If the company has more than 50 per cent of the capital or votes in another enterprise, the company is considered to have indirect ownership of this enterprise's ownership in other enterprises.

The fourth point is not to apply to the customary bank-client relationships.

- 3.2.5 At least two of the directors who are independent of the company and its management are also to be independent of the company's major shareholders. A director who represents a major owner or is employed or a member of the board in a company that is a major shareholder is not considered independent.

"A major shareholder" refers to owners who directly or indirectly control 10 per cent or more of the shares or votes in the company. If one company has more than 50 per cent of the capital or votes in another company, the first company is considered to have indirect control of the second company's ownership in other companies.

- 3.2.6 Members of the board are to be appointed for one year at a time.

### **3.3 Directors**

*The director's position in relation to the company is similar to that of a trustee. This means that the director is obliged to devote the time and the care and have the competence required to look after the interests of the company and its owners in the best possible manner.*

- 3.3.1 A director is not to have so many other duties that he or she is unable to devote the necessary time and care to the company's board work.
- 3.3.2 A director is to form an independent judgement on each matter considered by the board and to express the views and take the positions that follow from this judgement. A director is to request whatever supplementary information that he or she believes is necessary for the board to make well-founded decisions.
- 3.3.3 A director is obliged to acquire the familiarity with the company's operations, organisation, market, etc. needed to discharge his or her duties.
- 3.3.4 A new director is to receive the necessary introductory training about the company and any other training that the chair of the board and the director mutually consider appropriate.

### **3.4 The Chair of the Board of Directors**

*The chair has a special position in the board with explicit responsibility for seeing that the work of the board is well organised and efficiently conducted and that the board discharges its duties.*

- 3.4.1 The chair of the board is to be elected at the shareholders' meeting. If the chair relinquishes his or her duties during the mandate period, the board is to elect a chair from amongst its members to serve until the end of the next shareholders' meeting.
- 3.4.2 If the nomination committee proposes that the outgoing managing director, soon after leaving that position, become the chair, the committee is to give special cause for its proposal.
- 3.4.3 If the chair of the board is employed in the company or in addition to his or her responsibilities as chair, has duties assigned by the company, these may not involve tasks that are part of the managing director's responsibilities in the day-to-

day management of the company. In such cases, the division of work between the chair and the managing director is to be clearly stated in the formal work plan of the board of directors and in the board's instruction to the managing director.

3.4.4 The chair is to ensure that the work of the board is pursued effectively and that the board discharges its duties. Specifically, the chair is to:

- organise and lead the board's work, encourage an open and constructive discussion in the board in which all the directors participate, and create the best possible conditions for the board's work,
- ensure that the board regularly updates and improves its knowledge of the company and its operations and receives any other training required to conduct the board's work effectively,
- be receptive to owners' views and communicate these views to members of the board,
- keep in regular contact with the company's managing director and function as a discussion partner and support for the managing director,
- see that the board in its work receives sufficient information and supporting data on which to base its decisions,
- after consulting with the managing director, draw up proposals for the board meeting's agenda,
- verify that the board's decisions are implemented efficiently, and
- see that the work of the board is evaluated annually and that the nomination committee is informed of the result of the evaluation.

### **3.5 Board Procedures**

3.5.1 The board's statutory instructions in the form of its formal work plan, instruction to the managing director and reporting instruction are to be tailored to the company's circumstances and are to be so clear, detailed and functional that they can serve as guiding documents for the board's work. At least once a year, the board is to review the relevance and currency of these instructions.

- 3.5.2 The board may establish special committees to prepare the board's decisions in specific areas and, if the board considers it appropriate, to delegate certain decision-making powers to such committees. The establishment of committees must not cause the board to lose its overall view and control of the company's business activities. Nor must the board be any less well informed. The formal work plan of the board is to specify the duties and decision-making powers that the board has delegated to the committees and indicate how the committees are to report to the board. Committees are to keep minutes of their meetings and the minutes are to be communicated to the board.
- 3.5.3 The board is to evaluate the work of the managing director on a regular basis. At least once a year, the board is to take up this matter. At that time, no one from senior management is to be present.
- 3.5.4 The board is not to take decisions on important matters that have not been placed on the agenda, unless the board unanimously decides to do so.
- 3.5.5 The board is to be assisted by a board secretary who is not a member of the board.
- 3.5.6 The minutes of the board are to be a clear representation of the matters discussed, the supporting material available for each item and the content of the decisions taken. The minutes are to be sent to directors as soon as possible after the board meeting.

### **3.6 Financial Reporting**

*The board of directors is responsible for seeing that the company's financial reports have been prepared in accordance with the law, the relevant accounting standards and other requirements for listed companies.*

- 3.6.1 The annual report and interim reports are to make clear those parts that are formal financial statements, the regulatory regime on which they are based, and those parts of the annual report or interim report that are audited or reviewed by the company's auditors.<sup>5</sup>

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<sup>5</sup> Under IAS 1, financial statements refer to the income statement, the balance sheet, the statement of changes in equity, the cash flow statement and a statement of accounting principles and notes.

- 3.6.2 The board of directors and the managing director, immediately before signing the annual report, are to certify that to the best of their knowledge, the annual accounts have been prepared in accordance with good accounting practices for a stock market company and that the information presented is consistent with the actual conditions and that nothing of material value has been omitted that would affect the picture of the company presented in the annual report.
- 3.6.3 The company's six- or nine-month report is to be reviewed by the auditors.

### **3.7 Internal Control and Internal Auditing**

*The board is responsible for the company's internal control, which has the general aim of protecting the shareholders' investment and the company's assets.*

- 3.7.1 The board is to ensure that the company has a sound system of internal controls and keep itself informed of and assess how well it functions.
- 3.7.2 The board is to submit an annual report on how that part of internal control dealing with financial reporting is organised and how well it has functioned during the most recent financial year. The report is to be reviewed by the company's auditors.
- 3.7.3 The board in companies that do not have a special internal audit function is annually to evaluate the need of such a function and explain the position that it has taken in its report on internal control.

### **3.8 Accounting and Auditing Issues**

*The board is responsible for seeing that the company has a formal and transparent system that ensures that the principles established for financial reporting and internal control are observed and that appropriate relations with the company's auditors are maintained.*

- 3.8.1 The board is to document and present information on the manner in which the board ensures the quality of the financial reports and how it communicates with the company's auditors.

3.8.2 The board is to establish an audit committee consisting of at least three directors. The majority of the audit committee members are to be independent of the company and senior management. At least one member of the committee is to be independent of the company's major shareholders. A board member who is part of senior management may not be a member of the committee.

In companies with smaller boards, the entire board may perform the audit committee's tasks, provided that a director who is part of the senior management does not participate in the work.

3.8.3 The audit committee is to:

- be responsible for the preparation of the board's work to ensure the quality of the company's financial statements,<sup>6</sup>
- meet regularly with the company's auditors to keep informed of the aims and scope of the audit work and to discuss co-ordination between external and internal audit and views on the company's risks,
- establish guidelines on other services in addition to audit that the company is allowed to procure from the company's auditors,
- evaluate the audit work and inform the company's nomination committee, or where appropriate, the separate nomination committee appointed to propose auditors, of the result of the evaluation, and
- assist the company's nomination committee in preparing nominations for auditors and recommendations on audit fees.

3.8.4 At least once a year, the board is to meet the company's auditors without the managing director or any other company executive being present.

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<sup>6</sup> To ensure the quality of the financial statements, the committee normally has to consider all critical accounting questions and the financial reports presented by the company. The committee is presumed to consider matters such as internal control, regulatory compliance, material uncertainty in reported values, uncorrected errors, post-statement events, possible improprieties and other circumstances that may affect the quality of the financial statement information.

## **4 Company Management**

### **4.1 The Managing Director's Duties**

*Whether or not the managing director is a member of the board, he or she has a special role in the work of the board. As part of this role, the managing director reports to the board on the company's progress, submits reports and recommendations on matters prepared by company management and provides the board with information on which it bases its work.*

- 4.1.1 The managing director is to see that the board gets as objective, full and relevant an information basis as it requires to make well-founded decisions and that the board is kept informed of the progress of the company's business operations between board meetings.
- 4.1.2 The board is to approve any significant professional commitments of the managing director outside the company.

### **4.2 Senior Management Remuneration**

*The board is responsible for seeing that the company has a formal process, which is transparent for all board members, for establishing the company's policy for remuneration and other terms of employment for senior management and for deciding the managing director's remuneration and other terms of employment.*

- 4.2.1 The board is to establish a remuneration committee with the task of preparing proposals on remuneration and other terms of employment for senior management. The chair of the board may chair the remuneration committee. The other members of the committee are to be independent of the company and senior management. In companies with smaller boards, the entire board may perform the remuneration committee's tasks, provided that a director who is also part of the senior management does not participate in the work.
- 4.2.2 The board is to present a proposal for the company's policy on remuneration and other terms of employment for senior management to the annual general meeting for its approval. The proposal is to be posted on the company's web site in connection with the notice of the shareholders' meeting. The policy is to include:

- the relative importance of fixed and variable components of the remuneration and the linkage between performance and remuneration,
- the principal terms of bonus and incentive schemes,
- the principal terms of non-monetary benefits, pension, notice of termination and severance pay, and
- the members of senior management covered by the terms.

The proposal is to state whether the terms recommended differ significantly from the policy approved earlier by the shareholders' meeting and how matters of senior management remuneration are prepared and decided by the board.

- 4.2.3 The shareholders' meeting is to decide all share and share-price incentive schemes for senior management. The decision is to specify the maximum number of instruments that may be issued, the main terms of the allocation, the main terms and principles to be observed when estimating the value of the instrument and the latest date on which the instrument can be issued or transferred to senior management.

## **5 Information on Corporate Governance**

### **5.1 Corporate Governance Report**

- 5.1.1 A special report on corporate governance is to be attached to the company's annual report. The report is to include a statement on whether or not the company's auditors have reviewed it .<sup>7</sup>
- 5.1.2 In the corporate governance report, the company is to state that it is applying the Code and give a brief description of how this has been done in the most recent financial year. The company is to indicate where it has departed from the rules in the Code. The reasons for each departure are to be clearly explained.
- 5.1.3 The corporate governance report is to present information on the manner in which the board ensures the quality of the financial reports and communicates with the company's auditors in accordance with 3.8.1.

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<sup>7</sup> The report may be included in the printed annual report or constitute a separate report but it is not part of the formal financial statements.

5.1.4 The corporate governance report is also to provide the following information, if it is not included in the annual report:

- a statement explaining the procedures leading to the appointment of the board of directors and auditors,
- the composition of the company's nomination committee and where appropriate, a separate nomination committee appointed to propose auditors. If a member of such a committee has represented a particular owner, that owner's name is to be stated,
- for each member of the board, the information to be provided in accordance with the points listed in 2.2.3,
- for auditors, the information to be provided in accordance with the first and second sentences of 2.3.3,
- the division of work among directors and a statement on how the work of the board was conducted during the most recent financial year, including the number of board meetings and each member's attendance at board meetings,
- the composition, tasks and decision-making authority of board committees, if any, and each member's attendance at committee meetings,
- for the managing director:
  - age and principal education and work experience,
  - significant professional commitments outside the company,
  - his or her own holdings of shares and other financial instruments in the company or those holdings by related natural or legal persons,
  - material shareholdings and part ownership in enterprises with which the company has business ties,
- the policy on remuneration and other terms of employment for senior management approved at the most recent shareholders' meeting and, in the event of significant differences from the preceding year's terms, a statement of what these differences are and the procedures followed by the board in preparing matters of remuneration for senior management, and

- outstanding share and share-price incentive schemes for the board and senior management.

## **5.2 Report on Internal Controls**

- 5.2.1 The board's report on internal controls and the auditors' review of this report is to be appended to the company's annual report in accordance with 3.7.2.<sup>8</sup>

## **5.3 Information on the Company's Web Site**

- 5.3.1 The company is to have a special section on its web site for corporate governance matters. This section is to provide current information on the state of corporate governance in the company that is included in the corporate governance report, together with other information as required under the Code.<sup>9</sup>

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<sup>8</sup> This report may also be included in the printed annual report or constitute a separate report but it is not part of the formal financial statements.

<sup>9</sup> Companies that apply the Code should see that the information on corporate governance is easily accessible to shareholders and other interested parties by assembling this information in one place on the company's web site. It is important to keep this information reasonably current. Among other things, this means that much of the information called for under the requirements for the corporate governance report in 5.1 should be made available on the company's web site before the corporate governance report is published in conjunction with the annual report. The information on the web site should be updated at least after every shareholders' meeting and in connection with the issuance of the interim reports.