



## Corporate Board Elections and Internal Controls



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### Panel remarks by Pierre Delsaux, Head of Unit and Acting Director, DG Markt, European Commission

**Moderator: Myles V. Lynk, Peter Kiewit Foundation Professor of Law  
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Our next speaker Pierre Delsaux, Head of Unit and Acting Director of Free Movement of Capital, Company Law and Corporate Governance in the Internal Market Directorate-General of the European Commission.

**Pierre Delsaux:** Thank you very much. This morning the Chairman, in his introduction, said that one of the objectives of this meeting was also to compare American and European cuisine. Being a Belgian, we love food, so that's a good comparison for me. I would say that the topics we are discussing today is a good example of, basically, that on both sides of the Atlantic we want to reach the same goal, which is to prepare a tasty meal which will not be too difficult to digest for companies but to reach this objective we use different ingredients.

Why do we use different ingredients? If you look at the European situation, one of the problems is the fact that we don't have one kitchen but actually we have 25 kitchens. We have companies with a one-tier Board and two-tier Boards. Nobody has yet invented a three-tier Board but who knows, maybe that will come up in the future. We have worker participation. Not everywhere but in the majority of Member States. But even where we have worker participation, it's not the same level of worker participation otherwise it would be too easy. We have voting rights, one share one vote in certain countries. In some countries, if you remain a good shareholder for a certain period of time, by some kind of miracle your voting rights will be multiplied and you will two, three, four, five, even more than that. One other important difference is also the fact, as was explained by several speakers, that in Europe in most Member States we have block shareholders and, clearly, one result of this is that the relationship between shareholders and management is certainly different in this type of company as what we have in the States. That's important when you have to take into account a solution and approaches to these kinds of problems.

Now, coming back to the comparison between European and American cuisine, as I said, I believe we all have the same goals which is to make sure that effective internal control mechanisms are put into place because on both sides of the Atlantic. We consider that this is fundamental if we want to avoid corporate scandals, if we want to have efficiently run companies and, obviously, if we want to protect investors. So, the objectives are the same on both sides of the Atlantic. What is the difference? The difference is probably in the means, which we use to achieve such a result. To some extent it's a paradox because the US is perceived as a free country and you have decided to choose a so-called rule-based approach. To some extent Europe is perceived as a regulatory fortress and we have decided to choose the so-called principle-based approach. Actually, when you look at the detail, and this was already said by Alex Schaub, this comparison is not completely true because to some extent, even in the US where you have a rule-based approach, you still have some flexibility for judgement and that was clearly said this morning by Bill McDonough. You still have flexibility and not everything is a box with four sides. You still have some freedom.

On the contrary, when you look at the European situation, it's true, it's been defined as a principle-based approach but when you look more in detail you will see we have a lot of rules. Some of them are defined in legislation or legislations which are

going to be adopted at Committee level, some of them are maybe not defined in legislation but they are defined in codes which are actually followed by a large number of companies in Europe. So, when you look at the situation in Europe, you could say that you have rules, which are legally binding, and rules which are not legally binding but which are actually followed and implemented by listed companies.

So, when I look more closely at the mixture of rules, which exist in Europe, the first trend, the first element, is clearly this idea of legislation, directives which are in the process of being discussed and finalised at Committee level. Alex Schaub already mentioned the fact that we have two things which are in the process of being finalised in the following weeks or months, one of them being the Eighth Company Law Directive concerning the obligation to have an audit committee and the second one is the modification of the Fourth and Seventh Company Law Directives concerning accounting rules and the obligation to have an annual corporate governance statement. I'll look maybe a little more into the detail of these texts. I believe I still have time to do so.

First of all, the Eighth Company Law Directive, which, as we say, should be adopted within a few weeks or few months. The legislative process is always very slow in the committee because one of the problems is we have to translate everything into all languages which sometimes delays the adoption. When you look at this text, when it will be adopted, there will be an obligation for all listed companies in Europe to have an audit committee. This audit committee will have to be composed of at least one independent person and one person who is an expert in the field of audit and accounting. When you look at this text you see again the difference between the US approach and the European approach. For instance, the notion of independence is not defined in the directive itself. You don't have a definition of what is independence within the meaning of this directive. This definition is being left for the Member States themselves to define when they consider someone to be sufficiently independent to be part of an audit committee. But when you look again more closely you have to know that we have adopted at committee level a recommendation which is a non-binding instrument but still an important one, otherwise we wouldn't spend our time drafting such a thing. I know we are bureaucrats but still, we try to have a goal in what we do. We have drafted a recommendation, which is a non-binding instrument, which defines what we consider to be an independent director. Actually, in the real world, when the Member States will have to implement the directive, they will have to look at the same time at the obligation to have an independent director but also the recommendation itself and the criteria which are being used and contained in this recommendation to define what is an independent director who can be part of an audit committee.

The second aspect to which I would like to draw your attention to some extent is the fact that we have tried to avoid following a one size fits all approach. It's true that we have an obligation to have an audit committee but the way this obligation will be implemented will be different for smaller companies. For smaller companies we don't request that they have a specific audit committee separated from the administrative Board. So, we accept that you have some members of the Board being part of the audit committee under certain conditions - which I don't have time to explain now otherwise the Chairman will tell me to stop. On the expertise, again, we have simply an obligation to have an expert. Someone who understands something about accounting and auditing, which we consider to be something normal because if you have an audit committee it's something obvious that you need someone that understands at least a little bit what it's talking about, otherwise what's the purpose of having an audit committee? But, again, we don't have any definition of what level of expertise is expected from this person.

With respect to the role of this audit committee, this has already been explained by Alex Schaub. One of the aspects, which is very important, among others, is the fact that this audit committee will be there to monitor the effectiveness of the company's internal control and the risk management systems. There will be also a duty for the audit firm to report to the audit committee in particular on the material weaknesses in the internal controls, which might exist in a company. So, there is an obligation to disclose material weaknesses in the internal control to the audit committee and, obviously, some kind of transparency with respect to the shareholders.

The second text, which is now being discussed, is the draft Directive modifying the Fourth and Seventh Company Law Directives. Under this directive - when it will be adopted - there will be an obligation for all listed companies to have an annual corporate governance statement. In this annual corporate governance statement you will have to explain what is your internal control mechanism and what type of risk assessments you have put into place to avoid any problems. So, again, it's a question of explanation, disclosing to the public, disclosing to the market and to your shareholders what you have put into place. So, to some extent, from this point of view, it's a mechanism, which allows more freedom for the market to react.

One last element on which I would like to insist is the fact that in all Member States there are codes of corporate governance. These codes of corporate governance are very detailed and what is interesting to observe is that most of them are followed by all listed companies and that's very important to know. So, these codes might not be binding but, actually, they are implemented and enforced. Thank you very much.