SPEECH/08/537

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Challenges for corporate governance in the EU

7TH European Law and Corporate Governance Conference

Paris, 16 October 2008

Introduction

Ladies and Gentlemen,

I am very pleased to be here with you at this opening session of what promises to be a very interesting conference. I also would like to thank the Paris Bar and the MEDEF for hosting the conference.

In an ever increasing global, complex and competitive world, European companies need a modern governance framework.

As I am speaking at the beginning of the conference, I will use this opportunity to briefly mention some of the topics that will be discussed over the next two days. This will allow me to highlight some key features of an efficient and modern corporate governance framework – and those of you that know me well will not to be surprised to hear that I already have a view on at least some of them.

Regulation or self-regulation

One of the key issues for debate at this conference is the role of regulation vs self-regulation. I continue to believe that self-regulation has its benefits. It is flexible, and it allows companies to make their own choices. In the past 10 years or so, corporate governance codes have either been adopted or modernised in many European countries. These codes have, in general, served EU companies well. They are important instruments in the area of corporate governance. However, that does not mean that codes are always the right solution. In certain circumstances, binding rules may be necessary. The current financial crisis has pushed systems of corporate and internal governance across the global financial system to the limit. As we know, these systems have unfortunately been found wanting.

For the European Commission, and for me as a policy maker, one clear example is the role of credit rating agencies. Credit rating agencies played a major role in the market turmoil by greatly underestimating the credit risk of structured credit products. We can no longer leave it to the rating agencies themselves to deal with this. This business is much too important for the stability of the financial markets for us to sit by and watch from the sidelines. And that is why, I intend to propose in the next few weeks, a legally binding registration and external oversight regime whereby European regulators will supervise the policies and procedures followed by the CRAs. Reforms to the corporate and internal governance of rating agencies will also be included.

Another issue which the current turbulence has highlighted is the matter of remuneration especially, but not only, for executives. Serious questions are being asked about remuneration structures in financial institutions and the perverse incentives that are in place. Compensation incentives should not only focus on short term gains but overall shareholder interest and long-term, firm-wide, profitability. It is clear that some incentive schemes have led to excessive risk taking. Addressing these perverse incentives is, and has traditionally been in the first instance, the responsibility of industry and the financial institutions themselves.

But the current picture is not good. It seems that clearer guidance may be needed from policy makers. Only about a third of Member States followed the Commission's 2004 recommendation that shareholders should be able to vote on the remuneration criteria applying to board members. Shareholders must have a say on this - and they must be more engaged. However, I note that the issue of remuneration for executives now figures in some of the emergency measures that certain of our Member States have taken in response to the financial crisis. That must mean that the message is hitting home. The setting of incentives and excessive risk taking in remuneration structures are issues that will not go away.

New balance inside the board of directors

Another issue that you will be discussing and which is highly relevant to the current situation in the financial markets, is balance within the board of directors. When the Commission looked at this in 2004, we recommended that members of the board should have sufficient diversity of knowledge, judgement and experience. We also recommended the use of independent directors, in particular to mitigate conflict of interests.

Availability of independent board members alone is not a guarantee for a well functioning board. Indeed, the current turmoil has led many to question the usefulness of simply requiring independent board members. The whole of the board and the individual board members must not only be competent in relation to their tasks; they must also excercise a collective responsibility and due diligence with respect to the company. And I include non executive directors in this. That does not mean that companies should look for board members only within the traditional circles or the so called ´old boys' network. Why not cast the net wider.

Improved dialogue between issuers and shareholders

The question of dialogue between shareholders and issuers has been at the centre of our efforts on corporate governance over the past few years. I believe that a productive dialogue is essential. Shareholders need to have sufficient and adequate information about what is going on in the company so that they can form an opinion and take the necessary action. I am not referring to information overload, but rather to targeted and relevant information.

The effective exercise of shareholder rights was the main reason for the Shareholders rights Directive. This directive, which must be implemented by mid 2009, reduces the effort for shareholders to exercise their voting rights, but also ensures that they will be better informed by the company. Shareholders will receive certain information from the company prior to general meetings and they may ask questions of the company. This will lead to improved dialogue between shareholders and issuers. But it is not only a matter of tools. Shareholders must be in a position to monitor the actions of the company carefully.

There has been a lot of discussion about so called ´activist´ shareholders. I am convinced that active shareholders are a pillar of good corporate governance and have a role in the supervision of the company. But what if they become too active? And are they destructive if they only take a short term view? Here my answer is dialogue. Let shareholders explain their vision and their interests and share the philosophy of the management with them. In this respect, it should be noted that hedge funds, as a type of ´activist´ shareholders generally improve the performance of investee companies. This perception is widely held. But shareholders must not take on the role of management. Strong management with well organised, diligent boards, conscious of the long term health of the company is crucial.

More transparency during takeovers

Finally, a word on takeovers, which is linked to the issue of improved dialogue. The Takeovers Directive has now been implemented by all Member States. This Directive regulates several aspects of transparency during takeovers. It demands an early and effective publication of the decision to make a bid on a certain company. Moreover, the rules concerning the mandatory bid make it clear when a mandatory bid can be expected. After that, there are minimum requirements for the information included in the offer document, which will enable shareholders to make more informed decisions. Noteworthy in that respect is that bidders must also state in the offer document their intentions with regard to the future business of the company and the position of its employees.

With regard to transparency, during a takeover procedure but also in general, I would like to state that more information does not always bring better transparency or added value to market participants. While it is essential that the market is provided with a sufficient degree of clear information: too much or too complex information will create confusion rather than achieve the desired clarity.

If we recall the discussions on transparency of hedge funds and private equity investors, where some saw a need for additional transparency, I feel that we should be aware that there is a certain need for confidentiality of proprietary information for (professional) investors that must be balanced against the legitimate needs of the shareholders, the company, other stakeholders and regulators. The same argument is valid for investments by sovereign wealth funds, who are also professional investors.

Conclusion

Ladies and Gentlemen, I hope my remarks have provided food for thought for your debate over the next few days. These are challenging times for corporate governance in the EU. We must try and learn the lessons from the financial crisis. We must recognise where our rules have been found wanting and be mindful to strike the right balance, so we can ensure that EU companies remain globally competitive.

Thank you for your attention.