Corporate governance toward a new culture for disclosure, transparency and anti-corruption

Key findings of the 22nd European Corporate Governance Conference that took place in Sofia, Bulgaria on 19 April 2018

NATIONAL CORPORATE
GOVERNANCE COMMISSION

eu2018bg.bg
Българско председателство на
Съвета на Европейския съюз

EY
Building a better
working world


22nd
EUROPEAN
CORPORATE
GOVERNANCE
CONFERENCE
April 19, 2018 | Sofia, Bulgaria

Contents

- Introduction 2
- Foreword 3
- Opening remarks 4
- Company law and corporate governance developments in the European Union 6
- New culture of non-financial reporting and transparency 9
- Regaining trust: Anti-fraud and compliance in governance 13
- Governance challenges for cross-border companies and groups 16
- Principal conclusions 19

Introduction

Corporate governance and company law are absolutely essential to the effective functioning of a market economy. They encourage trust, which in turn underpins a business environment that delivers sustainable and inclusive growth, jobs and prosperity, while transforming society for the better.

The culture, controls and accountability that stem from good corporate governance provide the foundation of trust without which our market system fails. Trust helps us to manage risk, make effective decisions and create value. It is a vital ingredient in the relationship between businesses and their myriad stakeholders.

Today, more than ever before, we live in a world that is defined by distrust. Over the past decade, we have witnessed widening social inequality, rising economic and political uncertainty, and electoral results that reflect people's fears of being left behind by the global economy. The Edelman Trust Barometer remains at Distruster level, with 20 out of the 28 countries surveyed rated as Distrusters, up one from last year. Encouragingly, though, people are expecting businesses to play an increasingly bigger role in restoring trust. This is a vote of confidence in corporate governance, which provides accountability to the public interest.

At EY, we know that it is critical to restore trust, which is why we have been helping to drive the debate around inclusive capitalism. So what is inclusive capitalism, exactly? It's the idea that a company should not just focus on short-term results, but also seek to create long-term value that reaches stakeholders across society. Inclusive capitalism will only be achieved if businesses and governments work together on policies and strategies that allow everyone to participate in economic growth, and on tools that show investors, other stakeholders and companies themselves, how businesses are both creating value and impacting the world.

Unfortunately, many of the tools that we use to value and account for investments are more reflective of the age of the Industrial Revolution than the Digital Revolution that we see today. If you look at most businesses' balance sheets, over 50% of the value of the business relates to intangibles, yet we are failing to capture intangible value. Investments in hiring and training people are the very essence of inclusive capitalism. So, in light of digitalization and the rise of the robots in many parts of the world, we have to recognize the importance of investment in human capital.

Together, I hope that we can create a place in which our economy, and the businesses and institutions that operate within it, are underpinned by trust. This will be a forward-looking world that is continuously transforming itself to achieve sustained and inclusive growth that benefits all.

Andy Baldwin

Managing Partner for Europe, the Middle East, India and Africa, EY

Foreword

The theme of the 22nd European Corporate Governance Conference, "Corporate governance toward a new culture for disclosure, transparency and anti-corruption," addressed topics that matter greatly to every European citizen. These are building a new culture for transparency in corporate governance and fighting corruption. The speakers at the conference – among them legislators, policymakers, academics and representatives of both business and investor groups – discussed these topics rigorously and came up with some thoughtful observations and recommendations. Going forward, I believe that their observations and recommendations should encourage some joint initiatives to further best practice and more deeply embed the principles of responsible corporate governance within Organisations.

I am confident that the Bulgarian Presidency will continue to build on the results that the European Union has achieved to date in the areas of corporate governance and company law. In addition, it will continue the successful cooperation that already exists among stakeholders to find balanced, constructive and working solutions for a better internal market.

Thank you for reading this report and I hope that you continue to follow high professional and ethical standards in your own occupation and are successful in tackling the many challenges that face us in today's digital world.

Liliyana Pavlova

Minister for the Bulgarian Presidency of the Council of the European Union

Opening remarks


Desislava Ahladova

Bulgaria's Deputy Minister of Justice, Desislava Ahladova, addressed the conference on behalf of the Bulgarian government. She emphasized that effective anti-corruption continues to be a serious challenge for all European Union (EU) Member States and requires better coordination between countries. "We believe that participating in EU and international anti-corruption tools and initiatives for corporate governance is a prerequisite for protecting companies' interests and building business integrity," she said.

In a video message, Věra Jourová, European Commissioner for Justice, Consumers and Gender Equality, outlined some of the initiatives that the European Commission is working on in the area of corporate governance. These initiatives include: the company law package, unveiled in April 2018; proposed legislation to strengthen the protection of whistleblowers; and the action plan on sustainable finance. The action plan sets out a strategy for reorienting financial flows toward sustainable investment and includes measures intended to promote sustainable corporate governance and to attenuate short-termism in capital markets.

.

"Sustainable corporate governance means that corporate boards will have a long-term approach and take into account environmental and social sustainability challenges and opportunities, Jourová said."

Desislava Ahladova

Mathilde Mesnard

01

Company law and corporate governance developments in the European Union

The first panel discussed the latest developments in company law and corporate governance within the European Union (EU) and globally.

Mathilde Mesnard, Deputy Director for Financial and Enterprise Affairs, the Organisation for Economic Co-operation and Development (OECD)

Leena Linnainmaa, Chair, European Corporate Governance Codes Network (ECGCN)

Carmine Di Noia, Commissioner, Commissione Nazionale per le Società e la Borsa (Consob)

Josina Kamerling, Head of Regulatory Outreach EMEA, CFA Institute

Pedro Oliveira, Director for Legal Affairs, BusinessEurope

Ivan Takev, Bulgarian Stock Exchange, Chief Executive Officer

Salla Saastamoinen, Director, Department for Justice (DG Just), European Commission (moderator)

"In the aftermath of the financial crisis, citizens have lost trust in our governments, in our institutions in general, and in our businesses in particular."

Mathilde Mesnard
Deputy Director for Financial and Enterprise Affairs, OECD

In her keynote address, Mathilde Mesnard, Deputy Director for Financial and Enterprise Affairs at the Organisation for Economic Co-operation and Development (OECD), highlighted three major challenges for corporate governance today.

The first challenge relates to the need for flexibility and proportionality within corporate governance frameworks since circumstances vary between companies and countries while the economic landscape changes over time. Thus, corporate governance frameworks should allow for flexibility and proportionality, particularly with respect to company size, but also with respect to other factors, such as controlling ownership structure, geographical location, sector of activity and stage of development. The OECD's Corporate Governance Committee is conducting a review of all the criteria and mechanisms that may support flexibility and proportionality in the implementation of rules and regulations relating to corporate governance. This review will be published at the end of 2018.

"Corporate governance is not an end in itself, but is something to achieve the growth of companies. This is the only way to create prosperity and jobs."

Carmine Di Noia
Commissioner, Commissione Nazionale per le Società e la Borsa

Secondly, Mesnard discussed the potential for blockchain to improve shareholder engagement, increase transparency around ownership, facilitate efficient and fair shareholders' meetings and perhaps offer the possibility of real-time accounting with minimal need for auditing and verification. Nevertheless, Mesnard observed that blockchain also posed risks to corporate governance by removing the need for many intermediaries. "So whom and how will we regulate if there are no gatekeepers and intermediaries to follow our regulations and implement our standards?" she queried.

Finally, Mesnard said that the OECD is concerned by the trust crisis and believes this underlines the need for a more sustainable corporate governance framework. "In the aftermath of the financial crisis, citizens have lost trust in our governments, in our institutions in general, and in our businesses in particular," she said. "This brings us back to the foundations of the corporate governance debate. What is a firm, how should it be governed and for the benefit of whom?"

Mesnard emphasized that firms "need a social license to operate," which could mean that they have to change or reform their governance practices, theory and frameworks. Meanwhile, the OECD is looking at the coherence between different standards in areas such as anti-bribery corporate governance and responsible business conduct.

Lost in translation

Leena Linnainmaa, Chair of the European Corporate Governance Codes Network, shared Finland's experiences of implementing the Shareholder Rights Directive. She described the directive as an evolution, rather than a revolution, in Finnish corporate governance, since – for example – transparency on executive pay began in Finland in 2003.

Linnainmaa went on to warn that the directive is very detailed, which can give rise to inaccurate translations of the text. "We had a big problem with the translations," she explained. "If the directive says 'total remuneration', it is not the same as 'total amount of remuneration', so please be very careful not to over-interpret, because over-interpretation seems to be going on everywhere."

A further challenge with implementing the directive is that company structures differ by Member State, as do executive remuneration practices, yet the detail in the directive could convey the impression that executive remuneration packages should consist of certain specified components. "That should not be the case," Linnainmaa said. She added that the issue of whether the shareholders' vote on directors' remuneration should be binding or non-binding was a big political question in many countries. Linnainmaa also highlighted that the question of what constitutes a 'material related party transaction' is a national matter that triggers disclosures and special procedures.

Moderator Salla Saastamoinen, Director at the Department for Justice (DG Just) at the European Commission, observed that the Commission is running a public consultation on the implementing regulation of the Shareholder Rights Directive and called on those who are practically involved with implementing directive to reply to the consultation.

The case for consolidation

Carmine Di Noia, Commissioner at Commissione Nazionale per le Società e la Borsa (Consob), the Italian securities and exchange commission, said that much had been achieved in the area of corporate governance – not only at EU level, but also at OECD and G20 level. Now, however, he felt there was a need for some consolidation. He pointed to the European Commission's work in consolidating the company law directives, and reducing duplication and repetition in the text, as an example of consolidation that could be replicated in corporate governance. Reporting obligations, transparency directives and the new Shareholder Rights Directive could all be consolidated, he suggested. Nevertheless, he acknowledged that it would be challenging to consolidate two different sources of rules – directives and regulations.

Corporate governance matters because we should all believe that it is important to act in a good way, Di Noia said, "not only because there are public or private sanctions, but because it's worth behaving in this way". It is necessary to have good procedures, good boards and good monitoring systems in place, he noted, adding: "Corporate governance is not an end in itself, but is something to achieve the growth of companies. This is the only way to create prosperity and jobs."

A balance sheet of life

"We are at a crossroads," said Josina Kamerling, Head of Regulatory Outreach EMEA at the CFA Institute, who shared the investor's perspective on corporate governance with the conference. "We know the demographic trends, the ageing populations and we have the technological imprint, climate change and many other challenges facing us."

What retail investors need, said Kamerling, is to be able to look beyond their investments on a "balance sheet of life," where all their ins and outs are taken into account. "That is key for sustainability," she noted. Institutional investors increasingly realize that they have to consider environmental, social and governance (ESG) factors in their decision-making, but even here there are big differences between demographic groups. Women and millennials are much more concerned about ESG issues than baby boomers and men.

Mathilde Mesnard, Salla Saatamoinen, Carmine Di Noia, Josina Kamerling, Pedro Oliveira, Leena Linnainmaa, Ivan Takev.

The need for enablers

European businesses desperately need some enablers, said Pedro Oliveira, Director for Legal Affairs at BusinessEurope, the Confederation of European Business. He pointed out that businesses had recently navigated a steady stream of EU legislation, covering areas such as consumer law, data protection and geo-blocking, as well as matters relating to corporate governance, such as market abuse, non-financial reporting and shareholders' rights. Oliveira defined enablers as the "rules and frameworks that could help to stimulate entrepreneurship, but also create a healthy, vibrant, safe business environment in Europe".

Oliveira said that the European Commission's company law package potentially offered some enablers, for example, by giving companies greater cross-border mobility. "Currently, you can choose any company law regime in Europe, but once you choose it, you can probably never leave," Oliveira said. "It is important to create a simple procedure for companies to conduct their cross-border operations." Other enablers cited by Oliveira were having a recovery or 'second chance' regime to help companies bounce back from financial trouble, greater digitalization in the fields of company law and corporate governance, and making sure that the EU definition of an SME can also serve those small, dynamic companies that need to rely on venture capital to continue to thrive.

Shareholder engagement

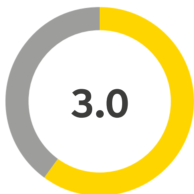
Institutional investors should be more engaged with corporate governance because they help to raise corporate governance standards, said Ivan Takev, Chief Executive Officer of the Bulgarian Stock Exchange. He noted that some of the worst incidents of bad corporate governance in Bulgaria had occurred because too few shareholders were present at shareholder general meetings where major decisions were taken with regard to management remuneration and related party transactions. "We need to be very active about bringing shareholders into the room when certain decisions are passed," he said. Takev revealed that the Central Security Depository of Bulgaria has developed an e-voting platform that should help to improve corporate governance among all Bulgarian listed companies.

Audience poll

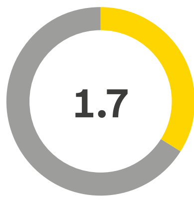
How do you see the role of the corporate board in conducting the business sustainably?*

They take care of balancing the interests of stakeholders

Various factors prevent them from balancing the interests of stakeholders

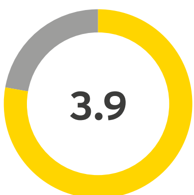


No role to play as regards developing sustainability



A company should manage the environmental, social and governance (ESG) impact of its operations?*

Within the scope of all its group companies and supply chain



Only within the country of its parent/ principal place of business

Only to the extent specified by applicable laws

**0 to 5 where 5 is very important*


Jonathan Labrey

02

New culture of non-financial reporting and transparency

This panel examined the impact on corporate governance and reporting of a shift toward a more intangible economy, a more pronounced focus on long-term results and demand from investors for greater transparency.

Jo Iwasaki, Head of Corporate Governance, ACCA

Irena Prijović, Chair, ecoDa

Bistra Boeva, Professor, the University of National and World Economy, Sofia

Claudia Kruse, Managing Director, Global Responsible Investment & Governance, APG Asset Management

Aleksandra Palinska, Senior Policy Adviser, EuropeanIssuers

Jonathan Labrey, Chief Strategy Officer, The International Integrated Reporting Council

Andrew Hobbs, Partner, EY EMEIA Public Policy Leader (moderator)

> "We expect people to behave in the right way when nobody else is looking."
>
> **Jo Iwasaki**
> Head of Corporate Governance, ACCA

"Corporate governance is at an inflection point," said Jonathan Labrey, Chief Strategy Officer for the International Integrated Reporting Council, in his keynote address. "Real and profound change is taking place in corporate governance rules, principles, standards and practice."

He identified three mega trends that are helping to drive change. The first is the "inexorable and permanent" shift toward an intangible economy. While most of the resources managed by companies in the twentieth century were tangible assets, today up to 80% of the value of companies in many markets is made up of intangibles such as brands, copyrights, patents and reputation. Furthermore, companies' ownership and control models are changing rapidly.

The second mega trend is a greater consciousness of the impact that individuals and companies are having on the environment and on society. The United Nations Sustainable Development Goals and the Paris climate accord have raised awareness of environmental and social issues, while political events have exposed a widening inequality in many countries and there will soon be a massive transfer of wealth to the millennial generation who wants to see change.

> "We don't need new layers of legislation. We just need better rules."
>
> **Aleksandra Palinska**
> Senior Policy Adviser, EuropeanIssuers

Labrey identified the third big mega trend as investors becoming more aware of how the financial system can be impacted by climate-related matters, sustainability issues and social unrest. Investors want to know how companies are integrating sustainability into their business models and strategy to demonstrate how they are creating value over the long term.

If companies want to regain the trust of society, they need to adopt a new mindset regarding the information that they share about themselves with others, concurred Andrew Hobbs, the panel moderator and EY's EMEIA Public Policy Leader. "It's a mindset of openness, transparency, authenticity and integrity." He added that companies should acknowledge the legitimacy of societal expectations around transparency if they want to maintain their social license to operate. "I don't believe this is about compliance and regulatory disclosure," he said. "It's about good information flows to drive better decision-making, capital allocation and accountability, not to mention better policy making."

What is culture?

"The reason why the word 'culture', and related concepts, feature in corporate governance is because we expect people to behave in the right way when nobody else is looking," observed Jo Iwasaki, Head of Corporate Governance at global accountancy body ACCA. So why is this not quite happening in practice?

The way to understand a company's culture, suggested Iwasaki, is not enough to look at its mission statement, or even what's going through the hearts and minds of its people. Research conducted by ACCA suggests that culture is closely correlated with an Organisation's processes and procedures. "Rather than look at mission statements, we, employees look at our pay slips to understand how our Organisation treats us," she said. "We look at who gets promoted, and who does not, to understand what sort of behavior and performance are considered to be good for the company. Those are the sources of what we consider to be culture."

Leaders, Iwasaki observed, do not only need to act in the right way but also to think about the positive impact that they can create within the Organisation. Unfortunately, however, fear, apathy and the unknown tend to hold leaders back.

Disclosure and risks

Irena Prijović, Chair of ecoDa, the European Confederation of Directors Associations, agreed that investors and other stakeholders now expect to receive more information on non-financial issues from companies. As a result, lots of reports are being produced, many of them unconnected with each other. She said that when providing information, management and directors have a delicate balance to strike in terms of disclosing too little or too much. There is information that is relevant for decision-making purposes, but which should not be disclosed in case it harms the competitiveness of the company, Prijović said. There is also a risk of over-disclosure with executive remuneration reports.

Most Member States do not demand high standards of verification with regard to the quality and accuracy of non-financial data in annual reports. So it is necessary to have a system in place to monitor the data and check it regularly, Prijović suggested, although this would inevitably result in companies paying additional costs. Furthermore, many boards are still not engaged with the idea of doing ESG reporting while in some Member States directors are held personally liable for false reporting, which can result in them being fined and imprisoned.

Cascading reporting standards from large companies, with large supply chains, down to small-and medium-sized companies is not necessarily appropriate since it is a huge administrative burden for SMEs, said Prijović. Also, compliance with additional corporate reporting is costly for all companies and a burden for boards. These considerations need to be weighed up against the benefits of providing additional reporting on ESG issues.


Jo Iwasaki

Communication, not information

Sustainability reporting is not only about providing narrative information; it is about clear messaging and providing the information that is most relevant to the company in question, said Professor Bistra Boeva, from the University of National and World Economy in Sofia. "We have to think about the traditional market and the market that drives us toward environmental issues."

Boeva pointed out that sustainable development is ultimately beneficial for everyone – individuals and companies alike – but she said that board members do not always have this mindset at present. "I'm very disappointed that we are sticking only to directives and regulations," she observed. There is a relationship between ethical behavior in a country and the quality of its auditing and accounting standards, Boeva continued. "I would like to convince people that it's not just about words; we have metrics that show it's about value creation and competitive advantage."

Sustainable financial markets

Claudia Kruse, Managing Director, Responsible Investment & Governance, at Dutch fiduciary manager APG, said that as a leading long-term responsible investor, APG was committed to contributing to a sustainable financial system. For this reason, she was a member of the European Commission High-Level Expert Group on Sustainable Finance, which has published its recommendations in a report entitled *Financing a Sustainable European Economy*. The report inspired the European Commission's action plan on sustainable finance. "At the core of the EU action plan is the development of a sustainable taxonomy, which will help to define what activities are considered sustainable and thereby create greater clarity for market participants," said Kruse. "That links directly to disclosures."

Kruse highlighted that the Commission had launched a consultation into the fitness of public reporting by companies in February 2018. Additionally, Kruse explained that the High-Level Expert Group had advised the European Commission to update the 'fit and proper' tests to include an assessment of both the individual and collective ability of the members of governing bodies in financial institutions to address long-term and sustainability risks. Another recommendation was that directors' duties at all companies, not just financial companies, should include sustainability.

Peer pressure and best practice

"Behaviors and culture are not really driven by legislation and rules," said Aleksandra Palinska, Senior Policy Adviser at EuropeanIssuers, which represents the interests of publicly listed companies in Europe. "We can impose them, but unfortunately they often lead to box checking, compliance and disclosures that do not always fully reflect what is happening in the company."

She put forward some alternative solutions for creating better cultures and behaviors including sharing best practices, creating awareness and explaining to companies and their leaders why it is necessary to act in a sustainable way and to disclose non-financial information. She also suggested that companies operating in less advanced capital markets need more time to adjust to new rules around disclosure of non-financial information, as well as flexibility in their frameworks around the information that they disclose.

Palinska welcomed the European Commission's consultation on the fitness check of public reporting by companies. She stressed that companies are faced with ever-increasing layers of regulatory requirements, which are often duplicative and inconsistent, and overlap with each other. For example, some companies have to report similar information to three different supervisory bodies to comply with EMIR (the European Market Infrastructure Regulation), MiFID (the Markets in Financial Instruments Directive) and REMIT (the Regulation on Wholesale Energy Market Integrity and Transparency). To ensure compliance, these companies have to set up three different internal processes. "We very much hope that the Commission will firstly focus on completing and analyzing the fitness check to see if there are any inconsistencies and overlaps before putting forward any new corporate reporting obligations," she said. "We don't need new layers of legislation. We just need better rules."

Andrew Hobbs, Jo Iwasaki, Irena Prijovic, Bistra Boeva, Claudia Kruse, Aleksandra Palinska

Audience poll

Who gets the most value from non-financial information and transparency?*

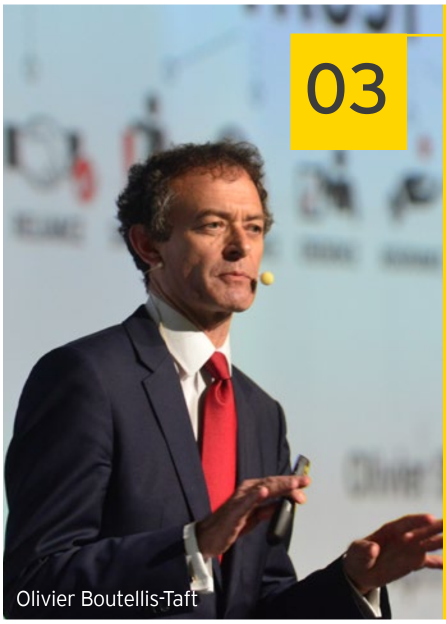
Investors | Non-governmental organisations | Employees, suppliers and creditors etc. | Governments and policymakers | Others

Non-financial reporting must be seen through a "value creation" lens*

Strongly agree

**0 to 5 where 5 is very important*

Johnatan Labrey, Andrew Hobbs, Jo Iwasaki, Irena Prijovic, Bistra Boeva, Claudia Kruse, Aleksandra Palinska.



Olivier Boutellis-Taft

03

Regaining trust: Anti-fraud and compliance in governance

This panel focused on whether it is enough for companies to comply with existing rules to combat fraud and corruption or whether they need to work harder at cascading ethical values down through the organisation.

Olivier Boutellis, Taft, CEO, Accountancy Europe

Sorana Baciu, Managing Partner, ACGENIO and President, the Independent Directors Association, Romania

Michel de Fabiani, Vice President, British Chamber of Commerce in France and Chairman of the Policy Committee, ecoDa

Rainer Riess, Director General of the Federation of European Stock Exchanges (FESE)

Jo Iwasaki, Head of Corporate Governance, ACCA

Svetlin Adrianov, Partner, Penkov, Markov & Partners

Nikolay Garnev, EY, Country Managing Partner, Bulgaria, FYR Macedonia, Albania, Kosovo (moderator)

We need to change the way we look at corporate governance, said Olivier Boutellis-Taft, CEO of Accountancy Europe, the European federation of accountancy bodies, in his keynote address. "The context that corporate governance is operating in has changed and if we don't respond to this change, not only will corporate governance become irrelevant, it will be extremely difficult to regain trust."

Corporates continue to be the "engines of developed societies," he continued, because they produce goods and services and provide income for pensioners and other investors. Nevertheless expectations of corporates, and public scrutiny of them, are greater than ever before. So corporate governance is an important tool for helping corporates to meet societal expectations and withstand scrutiny.

Today's shareholders are not just shareholders, said Olivier Boutellis-Taft. They are also parents and consumers, as well as machines that may only hold shares for a millisecond. So the challenge is to develop a model of shareholder value that reflects this reality. "Let's look at corporate governance as an ecosystem," he suggested, "and there is a role for all the elements of the ecosystem."

While much effort has been made to empower shareholders, corporates are more powerful than ever. Boutellis-Taft highlighted that 69 out of the 100 largest economies in the world are corporations, not countries. Power brings with it responsibility, he noted, which is why corporates should commit to supporting the United Nations' Sustainable Development Goals.

"The board should not just sit in a boardroom. It should go outside the boardroom, meet people and ask difficult questions."

Sorana Baciu
Managing Partner, ACGENIO and President, the Independent Directors Association, Romania

"We need to look more broadly at ethics and how we cultivate a culture that drives the proper behavior by everybody in the organisation."

Nikolay Garnev
EY, Country Managing Partner, Bulgaria, FYR Macedonia, Albania, Kosovo

Nikolay Garnev

Rules and procedures already exist but true change in corporate behaviors will only happen if those rules and procedures are enforced and if incentives that encourage short-termism are removed. It is essential, Boutellis-Taft added, that the right people, with the right competencies, are sitting around the boardroom table. "With corporate governance, you can have a very nice model, but if you don't have the right people, it doesn't work."

Rethinking compliance

Moderator Nikolay Garnev, EY's Country Managing Partner for Bulgaria, the former Yugoslav Republic of Macedonia, Albania, and Kosovo, said that legal compliance should be the minimum standard expected of companies. Nevertheless, this alone is not sufficient to address corruption and fraud. "We need to look more broadly at ethics and how we cultivate a culture that drives the proper behavior by everybody in the organisation," he explained.

EY's *Europe, Middle East, India and Africa Fraud Survey 2017* found that unethical behavior and high levels of mistrust among colleagues are key characteristics of today's workforce, with one in three board directors and senior managers — and one in four millennials — saying that they could justify offering cash payments to win or retain business. Furthermore, almost half (52%) of survey respondents who had had information or concerns about misconduct in their company had faced pressure to withhold information.

Sorana Baciu, Managing Partner of corporate governance association ACGENIO and President of Romania's Independent Directors Association, said that it's relatively easy for a company to adopt a code of ethics, but much harder to embed that code within the culture of the organisation. She suggested a few ways in which the board could achieve this. "First of all, the board should not just sit in a boardroom," she said. "It should go outside the boardroom, meet people and ask difficult questions. It should also make sure that there is the right structure in place for compliance — for example, a chief compliance officer."

Nikolay Garnev, Sorana Baciu, Sveltin Adrianov, Jo Iwasaki, Rainer Riess.

The board also needs to be clear about what an act of corruption looks like by giving examples and making sure that employees have dedicated training. "People do not understand that receiving a gift, in certain circumstances, is an act of corruption," said Baciu. Finally, the board needs to regularly review the ethics of the organisation on a 360-degree basis, by speaking to customers, suppliers and other stakeholders.

Fraud is a universal problem

No country, business sector, organisation or individual is immune from susceptibility to corruption or fraud, noted Michel de Fabiani, Vice President of the British Chamber of Commerce in France and Chairman of the Policy Committee of ecoDa, the European Confederation of Directors Associations.

De Fabiani also emphasized that rules on their own are not enough to prevent corruption or fraud from taking place. For example, the most corrupt countries often have a significant amount of anti-corruption legislation. Yet corporate governance can play an important role in combatting unethical activities. For example, non-executive directors can challenge management, check that business is being conducted in an ethical way, make sure that the right processes are in place to detect unethical practices, and be prepared to oppose investments proposed by management if they are ethically unsound.

The board should also have a risk committee that looks at a broad range of ethics-related topics, such as corruption, fraud, the environment, and health and safety, and compares how the organisation is performing with its customers and competitors. Furthermore, it must be informed of whistleblowing activity on a regular basis, including the number of incidents of unethical behavior that were reported and what the outcomes were.

Rainer Riess, Director General of the Federation of European Stock Exchanges (FESE), agreed with de Fabiani that while rules are important, having the right culture and values are also key to combatting unethical behavior within organisations. The board can help to create an ethical culture by setting the right tone at the top and examining the company's strategy and the ethics that are associated with that strategy, he said. Riess also warned that for smaller companies, rule making may have gone too far and resulted in them having a heavy compliance burden with too many box-ticking exercises.

Whistleblowers

It is often observed that most whistleblowing incidents take place shortly after Christmas. There is a good reason for this, according to Jo Iwasaki, ACCA's Head of Corporate Governance: "When you spend time with your family members, and talk about good times and bad times, that's the time when you think: 'I can't live with this secret inside my mind.' So that's the time when many corporate fraud investigation teams get very busy."

The decision to expose malpractice tends to have major implications for whistleblowers, Iwasaki continued. "It destroys their lives." Whistleblowers need protection, so Iwasaki recommended that companies introduce internal and external processes to allow people to make disclosures without compromising their anonymity. Often people are more willing to use internal channels if they have had a positive experience of using an external channel first. Companies should also make sure that they thoroughly analyze incidents that are disclosed and take appropriate action afterwards. Some companies report on whistleblowing, using aggregated data.

Referring to EY's Fraud Survey, Garnev said that if potential whistleblowers don't feel comfortable about speaking up internally, they are likely to go to external parties, such as journalists, regulators and even the competition, inflicting much greater damage on the organisation than if the incident had been kept in-house. He explained that when people don't blow the whistle, even though they know they should, it tends to be out of concern for their future career, fears over their personal safety and loyalty to colleagues or the company.

Peer pressure

Svetlin Adrianov, Partner at Bulgarian law firm Penkov, Markov & Partners, said that only a limited number of Bulgarian companies are large enough to be subject to corporate governance rules. So the general business environment in the country is critical when it comes to encouraging ethical behavior.

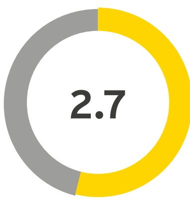
"All the participants in the market interact," he said. "Even if a small company does not have a compliance policy itself, it is affected by its business partners that do. There can be a big business where a decision-maker is tempted by a small supplier. Or there can be a small business that is forced to tolerate fraudulent behavior by a more powerful customer." A good environment can be created through educating people, management and companies, and through using business associations and chambers of commerce.

Audience poll

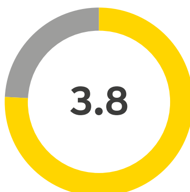
Do you think that compliance with European corporate governance requirements ensures fraud prevention within organisations?*

Yes, it ensures high degree of fraud prevention

Yes, partially – enhancements are needed



No – compliance alone is not sufficient



To what extent do you agree with this statement? "To harmonize internal governance in cross-border companies and groups under different legislation, we need a European group law with regulation about governance structures, functions etc."*

**0 to 5 where 5 is very important*

Guylaine Saucier

04 Governance challenges for cross-border companies and groups

The final panel examined the challenges facing cross-border groups and companies and explored whether a harmonized approach to governance, rules and procedures is a realistic objective.

Christian Strenger, Academic Director, Center for Corporate Governance, HHL Leipzig Graduate School of Management, Board Member of Deutsche Asset Management Investment GmbH, and Chairman of The Germany Funds, New York

Guylaine Saucier, Board Director and Audit Committee Chair, Wendel

Ralitza Germanova, Corporate Governance Officer, International Finance Corporation (IFC)

Prof. dr. Abigail Levrau, Research Director, GUBERNA

Luc Vansteenkiste, Chairman, EuropeanIssuers

Daniela Mattheus, Corporate Governance Board Services Leader, EY (moderator)

"It is important that we spend time ensuring that we understand the culture of the country and are compliant with its laws."

Guylaine Saucier
Board Director and Audit Committee Chair, Wendel

"The big challenge for directors of subsidiary companies is to balance local needs with group expectations. This is especially difficult and especially relevant in cases where interests are not aligned."

Prof. dr. Abigail Levrau
Research Director, Guberna

Introducing the panel discussion, Daniela Mattheus, Corporate Governance Board Services Leader at EY, said that fraud, compliance, policies and regulations all presented particular challenges to cross-border companies and groups.

Investors acknowledge that big, multinational companies cannot easily comply with so many different corporate governance codes and regulations because different countries have different cultures, different legal systems and different ways of doing things. This was the view of Christian Strenger, Academic Director of the Center for Corporate Governance at HHL Leipzig Graduate School of Management and a board member of two companies. Nevertheless, multinationals are expected to demonstrate best practice in corporate governance, not least because they are owned and funded by investors.

Strenger also explained that cross-border voting is still unsatisfactory for many investors. "Some companies aren't even keen on getting organized in a professional way so that their shareholders receive timely and full information and can vote until the last moment," he said.

Reputational risk

Guylaine Saucier, Board Director and Audit Committee Chair of French investment company Wendel, highlighted that operating cross-border increases the reputational risk faced by companies and groups. "When we work with different countries, we have to comply with the laws and regulation of those countries and we also have to ensure that our own code of ethics is implemented," she said. "So it is important that we spend time ensuring that we understand the culture of the country and are compliant with its laws."

A dilemma for the boards of multinational companies, Saucier continued, is whether they should lower some standards to ensure that the business remains competitive or insist that standards are maintained, whatever the cost. Quality of information is another consideration. "When we work in different countries, we may have different accounting and auditing standards," she said. "Even if we do have all the same standards, they are not implemented the same way. So we have to ensure that we have high-quality people in the different countries, who can understand our accounting standards."

Social responsibility is an important issue for boards, concluded Saucier, since companies are under pressure to pay their fair share of tax in the countries in which they operate. Country-by-country reporting of taxes by multinationals can therefore present some significant public relations challenges.

Governance in emerging markets

Ralitza Germanova, Corporate Governance Officer at the International Finance Corporation (IFC), outlined the governance challenges associated with emerging markets. The two key challenges are making sure that companies adhere to good standards of corporate governance, at both the parent and the subsidiary level, and making sure that investors have a complete picture of the risks and opportunities associated with emerging markets.

As a global financial development institution that encourages private sector development in developing countries, the IFC has developed its own practical tools for assessing corporate governance. One of these is the integrated ESG Progression Matrix, which aims to evaluate and improve the corporate governance of companies, including the governance of their key environmental and social procedures and their policies to identify, reduce and manage risks.

Another tool used by the IFC is its disclosure and transparency toolkit. This is a flexible reporting framework that companies of different sizes, in different locations, and with different degrees of operating complexity, can use to report material information about their strategy, governance and performance.

Andrew Hobbs

Balancing value and control

Prof. dr. Abigail Levrau, Research Director at Guberna, the Belgian Institute for Directors, identified two particular issues regarding governance in multinational companies and groups. The first is how the directors and management of the parent company govern the entities within the group in order to add value to the group by leveraging economies of scale at acceptable risk. The second is organizing governance at a subsidiary level within cross-border multinationals.

A parent board is responsible for establishing a governance framework that is consistent with applicable local legal requirements, with clear lines of authorities and accountabilities across the group. According to Levrau, this requires the parent board to develop a group-wide integrity policy and to set and communicate group values and culture. It is also important that the board fixes guidelines that identify when a subsidiary should report issues to the parent.

She added that it is necessary to find "the right group structure that achieves the appropriate balance between centralized and decentralized governance". This model would allow entities to derive the optimal strategic and economic benefit from being in a group, while complying with local regulation and having their own approaches to governance. "The big challenge for directors of subsidiary companies is to balance local needs with group expectations," said Levrau. "This is especially difficult and relevant in cases where interests are not aligned."

Burden on companies

Luc Vansteenkiste, Chairman of EuropeanIssuers, which represents the interests of publicly listed companies in Europe, noted that multinational companies must inevitably comply with a number of different corporate governance codes. What's more, these codes differ significantly from each other in terms of both principles and rules of application. Similarly, governance structures vary between Member States with some following a one-tier board system and others preferring a two-tier system. As a result, said Vansteenkiste, harmonization of corporate governance rules across Member States would be difficult to achieve.

Vansteenkiste warned that if listed companies were forced to report on environmental, social and governance issues, on top of their existing mandatory reporting, more would think about delisting. Hundreds of companies have already left European stock exchanges over the past five years.

Turning to the composition of boards, Vansteenkiste said: "An ideal board has very different people on it. The only traits that they should have in common are the capacity to challenge management and the ability to listen to each other and accept other points of view." He added that assessing the competency of the board, and the individual directors on the board, was key to driving better board performance, but noted that the quality of assessment often depended on the quality of the board chair undertaking the assessment.

Ralizta Germanova, Daniela Mattheus, Christian Strenger.

Principal conclusions

The conference reached a number of conclusions that can help to improve corporate governance within the EU. These, therefore, merit the consideration of policymakers:

1. Corporate governance frameworks should allow for flexibility and proportionality, particularly with respect to companies' size, location, sector, ownership structure and stage of development.
2. Existing corporate governance rules and frameworks would benefit from consolidation to reduce unnecessary duplication and repetition.
3. Inaccurate translations of official texts can lead to confusion and rules being interpreted in ways not necessarily intended by legislators.
4. The aim of reporting should be to communicate, rather than to simply transmit information. Hence, disclosures should drive better decision-making, capital allocation and accountability by companies, as well as better policy making by authorities.
5. Companies in less advanced capital markets need more time to adjust to new rules around disclosure of non-financial information, as well as flexibility in their frameworks regarding the information they disclose.
6. An increased regulatory burden on listed companies could result in more of them choosing to delist and leave the capital markets.
7. Good behaviors and culture are not driven by legislation and rules. They can be encouraged through the sharing of best practice, creating awareness and outlining the benefits of acting sustainably and disclosing non-financial information.
8. Effective corporate governance relies on more than just a good model. It is essential to have the right people sitting on the board.

Further reference

- ***Final report of the High-Level Expert Group on Sustainable Finance:***
https://ec.europa.eu/info/publications/180131-sustainable-finance-report_en

- ***European Union action plan on sustainable finance:***
https://ec.europa.eu/info/publications/180308-action-plan-sustainable-growth_en

- ***United Nations 17 Sustainable Development Goals:***
https://www.un.org/sustainabledevelopment/sustainable-development-goals

- ***EY Europe, Middle East, India and Africa Fraud Survey 2017:***
http://www.ey.com/Publication/vwLUAssets/EY_-_EMEIA_Fraud_Survey_2017/$FILE/ey-emeia-fraud-survey-2017.pdf

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

EYG no. 010395-18Gbl

ED None

ey.com