

ECGS responses to the E.C. Green paper on Corporate Governance

We are writing on behalf of European Corporate Governance Service (ECGS) registered in London, to comment on the European Commission's Green Paper on the EU Corporate Governance Framework for listed companies.

The ECGS is a partnership of independent local market experts which have come together to provide specialist governance research and proxy voting advice, offering institutions access to unrivalled experience on corporate governance and responsible investment issues. The Managing Partner of ECGS is Proxinvest based in Paris.

Other active ECGS Partners are DSW (Düsseldorf), Ethos Services (Geneva), Shareholder Support (Rotterdam). ECGS also employs local governance experts in Milan, Montréal and Melbourne. The ECGS acts solely in the interest of all shareholders and is free of conflicts of interests in the production and sale of its advisory services.

ECGS considers that, in view of the globalisation of the markets and of the frequent objection to national reforms in the name of equal footing competition, the EC has a high responsibility regarding fair financial markets rules and the efficient allocation of capital. We consider at ECGS that the fair treatment of shareholders resulting from a better corporate governance is the cornerstone of the financing of new investment and therefore of new employment.

We appreciate the opportunity to express our views and remain available for further discussion on our proposals. Please do not hesitate to contact Pierre-Henri Leroy our ECGS Managing Director, by phone +33 45 51 50 43 or email p.h.leroy@proxinvest.fr

E.C. Questions & ECGS responses

(1) Should EU corporate governance measures take into account the size of listed companies?

NO: protecting the investors is not linked to the size of companies. The equitable treatment of shareholders must prevail at all companies. Governance is defined as an effort to eliminate conflicts of interests or at least to limit their adverse effects: this should apply to both small and big listed companies. Clearly declarative overload which generally maintains the existing conflicts of interests is damaging and not only for small businesses. Regulation should therefore be limited to the minimum. Some benefits of the "comply or explain" process would be lost if it is no longer a voluntary exercise and a costly additional regulatory burden.

(2) Should any corporate governance measures be taken at EU level for unlisted companies? Should the EU focus on promoting development and application of voluntary codes for non-listed companies?

YES as too many rules, regulations and recommendations should be avoided as they discourage and more effective enforcement of the commercial law by courts is needed. A commercial law insuring the protection of the private shareholders should suffice: The compulsory "comply or explain" based on recommendation codes can create confusion between binding and non-binding rules. Voluntary codes for non-listed companies should be derived from the existing codes for listed companies (with appropriate adjustments reflecting the differences between listed and non-listed companies).

- **Board of Directors**

(3) Should the EU seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officer are clearly divided?

YES, supervision of the management ought to be split from the executive function. Such a necessary restoring of the normal agency chain belongs to commercial law. Most situations of abuse and crisis observed in the last twenty years seem to have been associated with the combination of functions at the top level. A Board already greatly weakened for their supervision by the presence of executive directors participating will generally be intimidated when it is chaired by the CEO, mastering both the agenda and the minutes.

In case of confusion of the functions, only a final personal questioning of the Chairman & CEO allows the board to overcome his personal opposition to any item of the agenda or to be tabled.

ECGS therefore believes that the combination of functions should be banned for all listed companies and all important public institutions.

(4) Should recruitment policies be more specific about the profile of directors, including the chairman, to ensure that they have the right skills and that the board is suitably diverse? If so, how could that be best achieved and at what level of governance, i.e. at national, EU or international level?

YES, but the first characteristic of the director is his independence, and recruiting should be subject to no other constraints than the report of an independent assessment for the Board, prior to its final free decision. All members of the nomination committee should be independent from management and at least a majority independent from dominant shareholders. The information remitted to shareholders should include full identities, core competencies, professional or other backgrounds, recent and all current board and management mandates at other companies, all factors affecting independence, board and committee meeting attendance. However, the recruitment of directors is a complex choice and should ultimately remain judgmental: for key investment it cannot be left to the sole mechanical objective analysis of profiles and needs a controlling diligence by shareholders. On the other hand, when the investment is accessory or located far away from the investor, the automated analysis of critical factors by independent proxy advisors is certainly useful.

For important investors it is even a core requirement to become involved in the nomination process. In line with the ICGN position, ECGS also considers that shareholders should be able to nominate directors to the board both:

- by proposing prospective candidates to the appropriate board committee
- by directly nominating candidates on the company's proxy.

(5) Should listed companies be required to disclose whether they have a diversity policy and, if so, describe its objectives and main content and regularly report on progress?

YES, gender diversity is highly desirable and the suggested declarative formula statement will be likely to be better accepted than legal quotas. Such useful minimal rules that emerge from the general interest should apply beyond listed companies, in all important administrative bodies as well as in private non-listed companies.

(6) Should listed companies be required to ensure a better gender balance on boards? If so, how?

YES, the investors voting policies must also play their role in enhancing diversity: they can for example sanction the chairman of the Board or of the nomination committee when failing in this respect. Investors should also be able to contribute to gender diversity by proposing appropriate external candidates to the Boards. When neither self-adjustment nor investor pressure are succeeding, a legal quota requirement would then appear justified.

(7) Do you believe there should be a measure at EU level limiting the number of mandates a non-executive director may hold? If so, how should it be formulated?

YES, the issue of lack of time and lack of availability in relation to the exercise of directors or executive officers mandates at listed or large organisations are understood by everyone. Non-executive directors should never accept more than five mandates outstanding at the same time, and no more than one other external mandate in addition to any such important executive function: these are the limits commonly recognised by some agencies or representatives proxy investors.

(8) Should listed companies be encouraged to conduct an external evaluation regularly (e.g. every three years)? If so, how could this be done?

YES: the external evaluation is certainly commendable, but only if the appraiser is selected by the independent members of the Board and not by the executive directors themselves. The nomination committee should be free to select other methods for a board evaluation, since the value of external evaluations can be overrated and usually are very costly.

(9) Should disclosure of remuneration policy, the annual remuneration report (a report on how the remuneration policy was implemented in the past year) and individual remuneration of executive and non-executive directors be mandatory?

YES. Good control of regulated related party agreements was led astray by certain national practices that have left the executive compensation to the sole jurisdiction of the Board. Publishing comprehensive and individualised pay and the applicable general remuneration policy has become essential.

The appraisal of pay policies by shareholders is very important and compulsory. Exhaustive publication should be encouraged with a fair international harmonisation, the E.C. being well positioned to issue equitable and complete disclosure rules.

(10) Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?

YES. A binding vote or at least an advisory vote of shareholders on the remuneration policy and the remuneration report has become necessary and inevitable.

11) Do you agree that the board should approve and take responsibility for the company's 'risk appetite' and report it meaningfully to shareholders? Should these disclosure arrangements also include relevant key societal risks?

YES but this seems already foreseen under commercial law, it should only be extended in jurisdictions that do not comprise these requirements. ECGS notes that the banking community wrongly attributed the causes of the financial crisis to a dysfunction within the risk taking process. The underestimation of risks has been particularly referred to, however conflicts of interests having driven the risk-taking has not been explored; the general result being an unfortunate increase in the cost of risk taking and cost of capital.

ECGS believes that it clearly remains the responsibility of Directors to analyse and bear all risks taken by the firm, including the risks that the company can impose on

society as a whole ("societal risk"). New types of disclosure requirements on risks in addition to the existing IFRS rules seem possible and appropriate only on the basis of a regulatory definition of these societal risks.

(12) Do you agree that the board should ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile?

YES, this seems already foreseen included in the legal IFRS duties: what is missing is the serious assessment by external auditors of every line of these statements on risk management. The creation of independent risk committees seems indispensable for the financial sector while the audit committees should take over these tasks in other industries.

- **Shareholders**

(13) Please point to any existing EU legal rules which, in your view, may contribute to inappropriate short-termism among investors and suggest how these rules could be changed to prevent such behaviour.

The most important short-term engine is likely to be the banking system as legalised in the EU and in many other countries. The short-termism of the markets is deeply linked in our opinion to the confusion of interests allowed by the universal banking license: multi-business financial groups will, in case of conflicts of business opportunities or conflicts of interests, give mechanically a priority to non-recurring transactions such as proprietary trading, brokerage or investment banking transactions. Typically, a big bank will prefer to court the management of a listed company for his next issuance of securities or any M&A mandate, rather than to serve the individual shareholders willing to vote at the AGM of the same company or considering to purchase or not purchase the company's securities. In a way these universal banks tend to vassal their own long-term activities such as credit, deposit or even asset management for third parties, in order to protect their highly profitable short-term activities.

We consider on the other hand, that the protection of the taxpayer for the banking sector is still perfectly legitimate because of the two systemic activities of deposit and credit.

Accordingly, one should consider if these State protected deposit and credit banks should still have access to the other competitive sectors as they freely do today, such as: markets brokerage and arbitrage, investment banking, asset management, insurance, real estate. A limitation of their license to the credit and deposit services would not only restore fair competition, it would improve the quality of services, end short-termism and terminate the conflicts of interest plague that is affecting financial markets, a situation which penalises the cost and the proper allocation of capital in most countries.

But such a major banking reform might take time to be accepted.

In the meantime ECGS also supports the following ICGN three proposals: reforming Solvency II which pushes institutions into investing in shorter-term assets. ECGS believes that observers instead of analyzing the systemic problem of banks and their mismanagement due to conflicts of interests have wrongly pointed at the sound long-term funding role of insurance companies. ECGS also supports the ICGN critique of MiFID which has allowed the entry of universal banks in the field of private exchange services and has reduced the liquidity of public markets and facilitated the short-term fast trading among big market names.

(14) Are there measures to be taken, and if so, which ones, as regards the incentive structures for and performance evaluation of asset managers managing long-term institutional investors' portfolios?

YES: One of our concerns is the bias toward short investment generated by short management mandates. The high water mark structure is the agreement that no performance fee is collected as long as losses from the past are compensated. The price of the fund should be above the level on which it stood the last time a performance fee was collected.

Preferably, a high water mark has an infinite duration, but a fund provider can also opt for such a period of one or three years. Using a high water mark should in any case ensure that no excessive risks are taken.

If the investments yield the wrong results, the fund manager can only collect the fixed fee after all, until he has compensated for his losses again. Some increased fees provisions or the "carried interest" provisions ensure excessive "upside" bonus income of managers: such provisions to be legally acceptable should take fully the downside performance into account never offer any income exceeding the cost of legal maximum rate, be computed from the performance of the overall portfolio, and should be acquired on an average of at least three years to limit any windfall profits.

(15) Should EU law promote more effective monitoring of asset managers by institutional investors with regard to strategies, costs, trading and the extent to which asset managers engage with the investee companies? If so, how?

YES. ECGS believes with ICGN that investors should at first be held responsible for ensuring a serious monitoring of their asset managers' performances and diligences. Besides, the exercise of the voting rights attached to shares should be made mandatory starting a minimum investment amount. Transparency requirements should be considered requiring public reporting by fund managers in each of these areas: proxy voting, engagement and collective repair actions.

(16) Should EU rules require a certain independence of the asset managers' governing body, for example from its parent company, or are other (legislative) measures needed to enhance disclosure and management of conflicts of interest?

When it comes to the investment of funds collected from an uninformed public, the same rules of good governance and transparency as those required of companies gathering public savings should be applied at the level of every fund and delegated managers: separate Chairman and executive functions, independence of

supervisors-auditors, independence of custodians, audits and evaluators, compensation disclosure among others.

Besides, when the asset manager belongs to a multi-business financial group, the requirement of a high degree of independence in the supervision is legitimate.

(17) What would be the best way for the EU to facilitate shareholder cooperation?

Voting has become expensive and inefficient for shareholders due to the widespread neglect of banking intermediaries: their role and certification of detention, a role that is and will remain indispensable and which has provided them with an opportunity to treat the voting process as an option and to charge a new fee for an optional service.

A/ General duty of care for intermediaries: the voting right and its exercise have an economic value, therefore anybody providing a service relating to stock should insure that its voting right and its equitable exercise be protected throughout the service process. As the core constituent of any contract on share related services the exercise of voting rights should never be treated as an accessory or optional item within the service of these intermediaries.

B/ Free production of the voting certificate associated with the detention of shares: it is at least necessary that the European legislator restates the principle that the free production of certificate of detention of shares by any intermediary or the free transfer of share entitlement by the issuer is a bundled part of securities conservation service, a non-optional element of the conservation service contract.

C/ Stimulate Internet voting facilities for shareholders: fifteen years after the advent of the Internet, Internet voting is still not functioning. The exclusivity of the role of the banking system in the certificate of detention is not debatable; however, protectionism within the banking system and its captive providers (SWIFT) resulted in the total ineffectiveness of the domestic and international voting process, the latest being slowed down by the conservation regime called "omnibus" U.S. banks. The common sense solution of malfunction is to stimulate the interbank chain with a layer of direct IP communication between the company having convened its meeting and the unknown but willingly voting investors. As a solution to encourage voting by absentee shareholders, ECGS commends the "temporary split between the voting instructions message to the issuer from the associated request of transfer of the ownership certificate by the chain of custody banks to the issuer". This split is the perfect solution for the identification of end investors despite the screen of "omnibus banks". Besides, it will offer a window for voting and dialogue of several weeks to investors and companies!

D/ Transparency of shareholding for all shareholders: under the principle of equal treatment of shareholders, transparency of ownership and free access to the full list of shareholders prior to and after the meeting must be the same for everyone,

whether a minority shareholder, a major shareholder of the company represented at the Board or a manager. This should imply the immediate posting of any significant change in shareholdings: the compulsory declaration of certain shareholding thresholds is aimed at protecting and informing all shareholders and not only management. The listed companies should be requested to post within 24 hours from their reception any declaration of legal or statutory thresholds. Similarly, regarding any identification survey on shareholdings, an expensive process paid by companies to banks (TIP) or specialised agencies we consider that in order to be an acceptable expense the lists from these private surveys should be made available to all shareholders or must be published immediately on the website of the company.

E/ Strictly limit the “concert action” qualification to real take-over situations with a final change of control: Another way to enhance shareholder cooperation is within the Takeover Bids Directive to insure that in no way the definition of “acting in concert” could be considered as a threat to investors willing to talk and finally to vote in the same direction while not willing themselves to take control of the company.

(18) Should EU law require proxy advisors to be more transparent, e.g. about their analytical methods, conflicts of interest and their policy for managing them and/or whether they apply a code of conduct? If so, how can this best be achieved?

YES. The mission of 'proxy advisors' in a competitive environment is to advise their customers, the investors, in a position identical to that of any private legal or financial advisor. As many other operators they should ensure the exclusion or at least the prevention of conflicts of interests and the disclosure of any of these. Proxy advisors should not sell consultancy services to issuers.

Their research should necessarily be paid, as for any professional advice cannot be offered for free to the general public. By contrast, issuers employ "proxy solicitors" paid by the companies who are not, despite of their conflicting position, subject to any constraints in their service for supporting the merits of the proposals of the Board and privately appealing voting mandates. The same transparency constraints should be imposed on 'proxy solicitors' employed by companies for it would be inappropriate to penalize 'proxy advisors' with requirements that would put them at a disadvantage compared to other advisors (lawyers, legal or financial liberal association of investors or managers ...), except for the respect of ethical rules preventing or excluding conflicts of interest.

(19) Do you believe that other (legislative) measures are necessary, e.g. restrictions on the ability of proxy advisors to provide consulting services to investee companies?

YES, potential conflicts of interest should be disclosed at all time, for example on the front cover of analyses so clients/readers know what relations exist between proxy advisers and investee companies.

(20) Do you see a need for a technical and/or legal European mechanism to help issuers identify their shareholders in order to facilitate dialogue on corporate governance issues? If so, do you believe this would also benefit cooperation between investors? Please provide details (e.g. objective(s) pursued, preferred instrument, frequency, level of detail and cost allocation).

YES as the identification mechanism currently used are generally in breach with the normal agency role: they allow the company to question the banks about the identity of their customers depositors, instead of inviting publicly all potential shareholders to instruct their bank if they are willing to vote. The current methods, inherited from the times before electronic communications, imply that the issuer gives the voting right and entitles the shareowner or shareholder. Typically, both the British section 793 of the UK Companies Act 2006 and the French 2001 identification regime "intermédiaire inscrit" allow a public company to issue a notice requiring a person to disclose certain information about their interest, subject to courts penalties in the UK and arbitrary depriving of voting right and dividend in France. Such mechanisms which hurt the shareholders rights as they offer excessive powers to the company. do not fully satisfy the issuers as it does not provide the information on the individual vote instructions of big foreign investors,

A strong demonstration of the accepted dysfunctions of the current identification and cross-border voting practices is offered in the hereby included March 2011 letter to AMF in the Wyser Pratte – Lagardère case. In this case a US dissident investor, having presented two external resolutions not supported by the board of Lagardère, complains to the French regulator, mentioning the contribution of several prominent international banks and proxy agencies, and claims that the final vote count of the two resolutions had been false by 20% of the total votes.

ECGS believes that in the case of public listed companies the entitlement of non-permanently registered shares should further be provided by the account holder and transferred by the chain of custodians to the company, but this on a simple request of the end-owner, the chain thereafter confirming it to the issuer and the end-owner, in full respect of the sound normal agency direction.

The effective Internet method mentioned above in response to question 17 would allow the dialogue: it is the temporary separation of the voting instructions from the transmission of the certificate chain by the banks. This process allows, at the initiative of the listed company, to open a dialogue for several weeks before each general meeting each shareholder with consent, without this intervention-needed intermediary bank, "proxy solicitors" or "proxy advisors" or other agents. This is the practical and simple condition for the perfect identification of willing and voting end investors despite the screen of "omnibus banks".

Finally, the EU should take measures to allow minority shareholders to file shareholder resolutions on the agenda of general meetings. In most states of the EU, the current conditions for filing are prohibitive, as they either require significant shareholdings or they impose heavy administrative burdens to minority shareholders willing to file resolution.

(21) Do you think that minority shareholders need additional rights to represent their interests effectively in companies with controlling or dominant shareholders?

YES, it is very important to protect shareholders when they invest in a company with a dominant shareholder: we believe that in such cases a strong representation of independent directors is needed as well as a strict and effective control of related party transactions (see below) and their approval by the next general meeting (with the exclusion of the beneficiaries from the vote). It is also important that whenever a majority of negative votes invalidate the transaction approved by the Board, national law should confirm that the meeting's decision is binding without having to go to courts.

The possibility for the investors to obtain a special control or expertise should also be generalised.

Finally, special protection is needed in case the company has several classes of shares.

(22) Do you think that minority shareholders need more protection against related party transactions? If so, what measures could be taken?

YES, an appropriate control of related party transactions should be implemented. Any agreement or contract insuring directly or indirectly a special benefit to any officer, director or important shareholder - above 5% of the shares - must be submitted to the General Assembly: it should be disclosed, justified and submitted to a vote of shareholders. The beneficiaries of these agreements should not participate in the vote. Should the transaction be not approved, it should be deemed illegal and cancelled immediately without any need for additional legal recourse.

(23) Are there measures to be taken, and if so, which ones, to promote at EU level employee share ownership? Monitoring and implementation of Corporate Governance Codes

YES: ECGS encourages employee ownership as employees can act as knowledgeable monitoring shareholders, however as such investment concentrates the risk profile of the employee it is quite important that the vehicle supervising the employees share portfolio is not under the control of the company's management regarding the choice of custodians and asset managers, the yearly voting decisions, and the eventual delivery of securities in case of public offering. It should be insured that, unlike in France and other countries, in respect of the European directive on shareholders rights, the company's management cannot participate directly or indirectly (shares lending) in the decisions on company shares held under employees benefit plans or options or free share plans.

- **Corporate Governance**

(24) Do you agree that companies departing from the recommendations of corporate governance codes should be required to provide detailed explanations for such departures and describe the alternative solutions adopted?

YES, the "comply or explain" process should remain a voluntary exercise and not a costly regulatory reporting. In case of non-compliance, the companies should however provide substantive justifications for their deviation from the code provisions.. There should be an independent oversight of the company's "explain" statements by the relevant authorities in each country.

Such comply and explain process is only meaningful when the codes of corporate governance are established by all parties and not written only by issuers' representatives.

(25) Do you agree that monitoring bodies should be authorized to check the informative quality of the explanations in the corporate governance statements and require companies to complete the explanations where necessary? If Yes, what exactly should be their role?

YES : simultaneous to the launching of the IFRS standards the appearance of ESG reporting, generally qualitative and more or less audited therefore less reliable, negatively affected the overall quality of financial reporting.

Auditors, while highly paid for multiple additional missions imposed by the new IFRS standards and the Sarbanes Oxley rules, have taken no responsibility on this self-appraisal, sometimes highly misleading ESG statement by the companies. Therefore Financial Markets Authorities should not only check the quality of information, they should challenge the liability of the signatories and auditors, including, if need be, imposing sanctions for lack of appropriate diligence by these.

21 July 2011

Attachment: Letter to AMF from MBL Avocats. Mr. Eric Bernard, partner at MBL Avocats Paris, expressly authorized on ECGS request the communication of this document.