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The Danish government's response to the Commission's Green Paper on the EU corporate governance framework

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General comments

The Danish government welcomes the Green Paper on the EU corporate governance framework and appreciates the opportunity to respond to it.

The Green Paper has identified some important questions on what should be the role, scope and content of the corporate governance framework in the EU. The Danish government supports the approach of asking and examining such questions as it is necessary to have a thorough debate on the future of the corporate governance framework in the EU before deciding on the way forward. Having such a debate and analysing *ex ante* the potential impacts of realising different possible directions for the future framework is useful and necessary in order to decide what ideas should be discarded and what ideas should be further developed. In that context it should be noted that it is just as useful to reach the conclusion that certain ideas *are not* the proper way forward as reaching the conclusion that the ideas *are* the way forward.

The Danish Government believes that any future regulatory initiatives in the field of corporate governance – as in the area of company law in general - should always satisfy the following key conditions:

- The objective and the need for a possible initiative has been clearly identified as a need for companies and/or relevant stakeholders
- Convincing arguments support that regulation is a better tool than leaving the matter to contractual freedom
- Compelling arguments support that EU regulation would meet the objective better than national regulation
- The scope of the possible initiative is carefully aligned with its objective
- The cost of regulation and impact on administrative burdens are taken into account and can be justified.

The Danish government finds that the general EU corporate governance framework needs to take into account the huge diversity of companies and also the different traditions and frameworks existing in the Member States. Good corporate governance can vary from company to company

depending on the activities, needs and solutions found for each company. This need for flexibility fits well with a soft law approach based on the comply-or-explain principle, whereas hard law should be avoided or reserved for particular cases where there is evidence that a soft law approach would not be sufficient and the costs of hard law are justifiable.

When contemplating on possible EU measures it is also very important not to add unnecessary or disproportionate administrative burdens on companies and not to take away the responsibility or influence of the shareholders as they are the owners of the companies. Shareholders right to be passive investors should also be respected. A flexible corporate governance framework build on disclosure and transparency still seems to be the most proportionate and sensible EU approach.

We have noted that the Commission has taken overlapping initiatives on corporate governance regulatory frameworks, i.e. for listed companies and financial companies respectively. Any potential new EU measures must be designed in a way that ensures that listed companies in the financial sector are faced with a coherent corporate governance framework. However, it is also important to stress that the crisis revealed more evidence of failures in the corporate governance framework of companies in the financial sector than failures in the corporate governance framework for listed companies in general. EU measures in the area of corporate governance in the financial sector should therefore not spill over on listed companies in general without clear evidence of a specific need in this area.

It should be stressed that Denmark fully supports the corporate governance initiatives taken in relation to the financial sector in CRD III. The following comments should be seen in that perspective.

It is the opinion of the Danish government that the Green Paper does not provide sufficient evidence for a need for EU action on several of the areas covered by the Green Paper. Only in a few areas there seems to be a need for further reflections on possible EU actions, notably actions that could ensure a better application and functioning of the "comply-or-explain" principle and the separation of the roles of the chairman of the board and the CEO.

Specific comments

Question 1 and 2

The Danish government does not see sufficient evidence for a need neither to establish a differentiated EU corporate governance regime for small and medium-sized listed companies nor to develop EU corporate governance measures for unlisted companies. The justification for any corporate governance rules should be related to the status of a company

being listed and thus raising money via public markets, and potentially having many shareholders and investors.

Instead the EU corporate governance regime for listed companies should be sufficiently flexible to take into account also the different needs of SME's. This is one of the strengths of the "comply-or-explain" approach. Furthermore, one set of rules ensures a higher level of transparency, as investors, the press and other interested parties might find it difficult to distinguish between large and small listed companies.

Unlisted companies are significantly different from listed companies as they do not have shares listed for public trading and generally do not have a much dispersed ownership. Therefore the need for transparency for minority shareholders and the public is not the same as for listed companies.

It should be noted that the Danish government supports CSR-reporting also for large unlisted companies, but that we do not consider CSR-reporting as part of the corporate governance framework.

Question 3

Yes, the EU should seek to ensure that the functions and duties of the chairperson of the board of directors and the chief executive officer are clearly divided. It is essential for the proper functioning of the checks and balances in the corporate governance system that the responsibilities of senior management (executive directors) and the board of directors (non-executive directors) are clearly divided, and that conflicts of interest are avoided. Especially the chairperson of the board is important in this context.

It is thus in the interests of the companies and their stakeholders and ultimately for the effectiveness of the capital market to ensure a clear division. Evidence shows that such division is not always the case for listed companies in Europe. This results in an uneven playing field for companies in the EU and it increases the risk of distrust from investors and others to the detriment of an efficient internal market for capital.

Therefore the Danish government believes that in this particular area the existing Commission Recommendation 2005/162/EC is not enough. The Danish government supports an EU prohibition, possibly in a directive.

It should be noted that in Denmark, in order to ensure a proper separation of the roles of executive directors and non-executive directors, the majority of the persons in the board must be non-executive directors, and it is prohibited for the chairperson of the board to be an executive director (i.e. not just the CEO) in the same company at the same time since. These rules are stipulated in the Companies Act and therefore apply to all public limited-liability companies, not only listed companies.

Question 4-6

The existing Commission Recommendation 2005/162/EC already contains provisions on recruitment policies, qualifications and diversity of board members. These provisions appear to be sufficient.

The composition of the board and the skills of its members, individually and collectively, must at all times reflect the demands posed by the company's situation and circumstances.

The Danish government agrees that diversity on boards may improve the quality of the work performed by the board and thus benefit the company. Therefore diversity should be encouraged but not at an EU level.

It should be noted that gender balance is just one of several criteria relevant for diversity, and that diversity should not be considered more important than expertise which should remain the most important criteria. Therefore companies should not be required to ensure a better *gender balance*. There can be good reasons for a certain composition of a board that does not have great gender balance. It is the task of the board of directors to specify and publish which competencies it needs in order for this to be debated at the general meeting. This is already recommended by the Danish Corporate Governance Committee (hereafter DCG-Committee).

The shareholders who own the company and carry the main economic risk of the company should remain responsible for the composition of the board.

The Danish government is of the opinion that one of the main reasons for the lack of women on boards is the lack of women with experience from an executive position. Efforts therefore need to be done to promote more women in management positions. This will give more women the qualifications they need to be recruited for boards. On the contrary, establishing gender quotas on boards will not ensure that more women get the necessary qualifications.

Instead the Danish government believes in a close cooperation with the business community in promoting the basis for recruiting women on boards. For instance the Danish Government has established several projects to this aim including "Charter for more women on boards" and "Operation chain reaction – Recommendations for more women in management".

It seems doubtful whether adding more detailed requirements to *the recruitment policies* will add much value, as it is already in the spirit of the existing recommendation that the (supervisory) board should take into account its desired composition in relation to the company's structure and activities when recruiting new candidates to the (supervisory) board.

Further reflection is needed to determine whether listed companies should disclose whether they have a *diversity policy* and, if this is the case, describe its objectives and main content and regularly report on progress. The question is whether such a requirement would be proportionate with respect to the importance of the information for the public. The more listed companies are required to report the higher is the risk of information over-flow, thus reducing the benefits of disclosure. Administrative burden considerations are also important. It would seem that a potential requirement should not go beyond a recommendation supplemented by the comply-or-explain principle and potential administrative burdens should be analysed first.

Question 7

Sufficient time devotion is crucial for the well functioning of a board. Therefore the number of mandates occupied by a director, and other relevant time constraints, should be a criterion that should not be neglected when considering the appropriateness of a potential board member.

However, it varies widely how time demanding a mandate is, as it will depend, inter alia, on the size and complexity of the particular company and on the individual background of the director. Setting an arbitrary threshold on the maximum number of mandates a non-executive director may have does not ensure that non-executive directors devote sufficient time to their duties and does not take into account the differences mentioned. It necessitates a qualitative and individual evaluation.

The existing recommendation on the time commitment of directors in Commission Recommendation 2005/162/EC is sufficient.

Setting an arbitrary threshold or other mandatory limits on who can be elected as board members, would also conflict with shareholders' right to compose the board they think is the best for the company.

Question 8

Self-evaluation can be useful to promote well-functioning boards and increase their performance. The Commission Recommendation 2005/162/EC already recommends such self-evaluation.

The use of external consultants in the evaluation process can also be useful, at least sometimes. However, there are many different ways of self-evaluation and it should be for the board to decide how the evaluation process should be designed. This would also ensure the necessary commitment and candidness for the evaluation process to add value. However, there should be a certain level of transparency on how the process is organised, so the shareholders can evaluate the board when deciding the composition of the board. This is already recommended by the Danish DCG-committee.

Mandatory external evaluations could be counter productive and result in administrative burdens more than it will add value for the board performances. External evaluations should therefore remain only a recommendation.

Questions 9 and 10

The Danish government supports openness and shareholder influence on the remuneration policy of listed companies. It could be relevant to encourage disclosure of the remuneration policy, the annual remuneration report and the individual remuneration of executive and non-executive directors and encourage putting the remuneration policy and remuneration report to a vote on the general meeting to allow for shareholders' input.

However, this is already encouraged as it is part of Commission Recommendation 2004/913/EC. The Danish government believes that the Commission should provide more evidence for a need to turn the recommendation into a mandatory requirement and the consequences of doing so before taking any further steps in this direction.

Question 11

The Danish government agrees that the board should approve and take responsibility for the company's risk appetite and report it meaningfully to shareholders. However, this seems already to be the case in most, if not all, Member States.

As regards the reporting of risk appetite to the shareholders the Transparency Directive (Art. 4(2)) requires the annual financial report to include a description of the principal risks and uncertainties that the companies face. The reporting of relevant key societal risks seems to be related more for CSR-reporting than for financial reporting. In case key societal risks are relevant for the financial reporting they should already be included in the description of risks pursuant to the Transparency Directive.

Question 12

Yes, the board should ensure that the company's risk management arrangements are effective and commensurate with the company's risk profile. This also seems already to be the case today. A convincing need for EU action has not been presented so far.

Question 13

At this stage, the Danish government has not identified any existing EU rules which, in our view, may contribute to inappropriate short-positions among investors.

We find it, however, important to distinguish between the problem of short-termism and the problem of non-appropriate shareholder engagement. High frequency trading is not necessarily inappropriate.

A possible measure to promote long-term investments could be to enhance transparency. Transparency could contribute to more ownership feeling and thereby long-term investments. In particular, challenges concerning "hidden ownership" should be analysed and it should be considered whether more emphasis on notification rules is needed. The analysis of "hidden ownership" is already taking place as part of the Commission's review of the Transparency Directive. The Danish government finds that regulatory initiatives in this regard are not needed in the corporate governance framework.

High frequency trading is a behaviour caused by the market development. High frequency trading ensures liquidity in shares and a better pricing mechanism at the market and therefore the high activity as such does not harm corporate governance. We find that the Commission's review of the MiFID and MAD directives will be adequate to regulate that high frequency trading is done in a prudent manner and therefore regulatory initiatives regarding high frequency trading is not needed in the corporate governance framework.

Question 14-15

It is the task of long-term institutional investors to monitor and evaluate the quality of asset managers' performance and remuneration. The listed companies themselves have no influence on this subject. The Danish government is therefore of the opinion that regulation in company law or in the field of corporate governance is not the right place to tackle any identified problems in this area.

Question 16 and 18

The Danish government finds that adequate and sound rules on transparency, inducement and the counteraction of conflicts of interest (regarding the role of advisers) are essential and are present in the MiFID directive. From a Danish perspective, we would urge the Commission to await the review of the MiFID directive which is currently taking place and which could even further strengthen the area.

The Danish government would like to emphasise that retail investors should be informed about advisor-related costs. In the UCITS V directive, the Key Investor Information Document (KIID), the information on costs should be broader to ensure that all direct and indirect trading and administration costs are included.

However, it is important that the costs of any measure in this field match the results achieved.

Question 17

The Danish authorities and stakeholder organisations are not aware of significant problems in this area, and we are doubtful whether there is a role for EU to play in this area. The EU has a role in ensuring that listed

companies disclose information *to* their shareholders, whereas information *between* shareholders is a different issue.

Requirements for companies to facilitate shareholder engagement could impose major administrative burdens on the companies without any or little added value. The companies would for instance need to set up electronic systems, introduce and maintain security standards to ensure that only shareholders access the network, monitor the correspondence etc.

If companies find added value in doing this they can already do it. However, it is difficult to see the need to force companies to do so. Shareholders nowadays have the possibility to communicate via shareholder fora/social networks on the internet.

Question 19
The Danish government has not identified the need to introduce regulation in this area.

Question 20
The Danish government has not identified 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. Listed companies already have the possibility to contact major shareholders, cf. the rules in the Transparency Directive on notification of the acquisition or disposal of major holdings.

Questions 21-22
There does not appear to be a need for further protection, at the EU level, of minority shareholders against related party transactions and in companies with controlling or dominant shareholders. The IFRS standards, the 4th Company Law Directive and the corporate governance recommendations supplemented with the comply-or-explain principle already provide protection in these areas and to the extent a particular Member State thinks further protection is necessary national legislation will provide such protection.

National legislation also has the advantage of being able to adapt the rules on minority protection to the specific national setting, culture and company structure.

It should be noted that companies with controlling or dominant shareholders can strengthen the basis for good corporate governance since concentrated shareholdings provide a good basis for active ownership and dialogue between the owners and the management of the company.

Question 23
It should remain the decision of the individual company to decide if they think employee share ownership in their company should be promoted or

not. There has been presented no convincing justification for promoting employee share ownership at EU level and it is difficult to see what the justification should be. Furthermore, employee share ownership is not a question of corporate governance.

Question 24

The Danish government believes that the combination of recommendations and the comply-or-explain principle should remain the core instruments used in the EU corporate governance framework. Therefore, efforts should be done to make it work as efficiently as possible.

It is the strength of the comply-or-explain principle that companies can decide not to follow a recommendation if they believe it is not in their interest to do so, but that in return they provide shareholders, investors and other stakeholders with an explanation for any departure they make. Such explanation naturally must be meaningful and therefore needs to have enough detail to make it meaningful. It would also be natural to describe the alternative solutions adopted.

On the other hand companies should not be faced with more detailed requirements than necessary to ensure a proper functioning of the comply-or-explain principle.

Question 25

Primarily, it is up to the market and the investors to evaluate the corporate governance of a company. However, this can only be done, if there is enough transparency.

In Denmark the monitoring bodies are authorised to check the informative quality of the explanations in the corporate governance statements and can require companies to complete the explanations where necessary or to issue new correct corporate governance statements. The monitoring bodies do not interfere with the content of the information disclosed or make business judgements on the solution chosen by the company.

The Danish government supports that something similar is introduced in all Member States.