EUROPEAN COMMISSION ACTION PLAN ON COMPANY LAW AND CORPORATE GOVERNANCE
Report of the ECGI academic conference held on 23 January 2013 in Brussels to discuss the Action Plan

Introduction

On 12 December 2012, the European Commission published the Action Plan which outlined the initiatives that the Commission intends to take in order to modernise the company law and corporate governance framework. See Appendix 1 for reference documents. The Action Plan identified three main lines of action:

- **Enhancing transparency** – companies need to provide better information about their corporate governance to their investors and society at large. At the same time companies should be allowed to know who their shareholders are and institutional investors should be more transparent about their voting policies so that a more fruitful dialogue on corporate governance matters can take place.
- **Engaging shareholders** – shareholders should be encouraged to engage more in corporate governance. They should be offered more possibilities to oversee remuneration policy and related party transactions, and shareholder cooperation to this end should be made easier. In addition, a limited number of obligations will need to be imposed on institutional investors, asset managers and proxy advisors to bring about effective engagement.
- **Supporting companies' growth and their competitiveness** – there is a need to simplify cross-border operations of European businesses, particularly in the case of small and medium-sized companies.

The Action Plan followed a period of consultation undertaken by the Commission after its publication of two Green Papers, the first in June 2010 on the Corporate Governance of Financial Institutions and the second in April 2011 on Corporate Governance of all European corporations. It also followed an academic conference organised by ECGI in September 2011 to identify the corporate governance research agenda of relevance to issues raised in the two Green Papers.

With the publication of the Action Plan, with the support of the European Commission and with sponsorship from the London Business School's Centre for Corporate Governance, the ECGI held a further academic conference on 23 January 2013 to discuss the implications of the Plan. Those attending the meeting were ECGI Research and Board Members, representatives of European Commission DG Internal Market and Services, the London Business School Centre for Corporate Governance, and a number of invited guests and observers. See Appendix 2 for a list of those who attended.

The meeting was structured in four sessions as follows:

- **Session 1: The European Commission Action Plan**
  Chaired by Marco Becht with presentations from Pierre-Henri Conac and Joe McCahery
- **Session 2: Diversity on Boards**
  Chaired by Karin Thorburn with presentations from Paolo Giudici and Maria Isabel Saez Lacave

- **Session 3: Short-termism – The Kay Review**
  Chaired by: Julian Franks with presentations from Mike Burkart, Maria Gutiérrez Urtiaga, Stefano Lombardo, Fausto Panunzi and Theo Vermaelen
- **Session 4: Bank Governance, Remuneration and Resolution**
  Chaired by: Colin Mayer with briefing from Tom Snels, DG Markt and presentations from Arturo Bris, Christoph Van der Elst, Holger Fleischer, Klaus Hopt, Peter Muelbert and Alessio Pacces

This report summarises the main observations of the participants. Where slides were used by speakers, this report identifies that use and copies of the slide presentations can be found in Appendix 3 or can be downloaded from the ECGI website at
http://www.ecgi.org/conferences/eu_actionplan2013/index.php

SESSION 1: THE EUROPEAN COMMISSION ACTION PLAN
Chaired by Professor Marco Becht, Professor of Finance and Economics, Université Libre de Bruxelles (ULB)

Introduction
Introducing the session with slides (see Appendix 3), **Professor Becht** commented on the lack of research into the issue of 'comply or explain', and expressed his hope that this was something which ECGI members might be able to address in the future. On the proposals by the Commission to remove cross-border obstacles to employee share ownership, he acknowledged that while this was clearly something which the Commission should do, he wondered if in practice this would prove difficult to achieve.

In the first of the presentations by ECGI research members, **Professor Joe McCahery** commented on the issues of enhancing transparency, engaging shareholders and business forums. He drew particular attention to aspects of 'risk management strategy', pointing out that the Action Plan dealt with non-financial risk management, not covered therefore by IFRS. Risk management is outsourced by many financial institutions and it is difficult to see how much more traction this issue would get at EU level. Generally, the supervision of risk management is as well done at country level within the EU and the USA.

Commenting on the 'comply or explain' issue, he opined that institutions wanted context and mitigation.

In relation to disclosure of voting policies by institutions, Dutch surveys and other empirical studies showed that engagement and resources had been committed and went beyond the 'declared' policy: it was perhaps difficult to ask more.

He then commented on proxy adviser reform: He identified the issues of methodology, conflicts of interest and consistency of quality (i.e. accounting for local market conditions) as the main concerns. A code of conduct would be preferred over mandatory disclosure and a new set of procedural rules.

On the topic of cross-border measures in the Action Plan, he said that a lot of academic work had been done in Germany on the European Company (SE). The SE was a popular vehicle for enhancing corporate governance at the cross-border level. Innovative companies used it and found that the benefits were manifest. The process was not burdensome, but numbers were still rather small (less than 1000), and many (40%) were 'off the shelf' companies. It was still expensive, however, and if ways could be found to reduce costs, it would, maybe, become more popular.

Professor Pierre-Henri Conac said that his general view was that the Action Plan was an important step, but not the final answer. Nevertheless, it was 'better than nothing.' It wasn't, he felt, however, very ambitious. There was a clear distinction between listed and non-listed companies. More forward thinking was a feature in relation to non-listed companies and it was regrettable that the same thinking did not appear in relation to listed companies.

On cross-border issues, there were some technical proposals in the Plan, but despite case law, indicating that a transfer of seat cross-border could be legitimately done, it needed a Directive to force the issue, especially for smaller companies and groups.

Shareholder identification was a very important issue because at present, all systems stopped at the border.

On corporate governance, the forcing of disclosure of directors' remuneration was something on which he had originally been unconvinced but now was feeling more positive. He was very interested in the UK proposed legislation to require a binding vote.

The proposed work on acting in concert in order to enable greater shareholder collaboration was good thinking, he concluded.

General Discussion

In a *tour de table* of the researchers, the discussion ranged over many issues which can be summarised as follows:

'Say on pay'

Should this be for the EU or for member states? The UK seemed to be in the lead in terms of a binding vote, but was that alone going to stop excesses? Transparency was in one view the most important factor. There was evidence, however, that showed that pay actually went up when shareholders voted on it. Reference was made to the German experience where in the past three years, only one vote against had been recorded.

It was also argued that the primary virtue of shareholder 'say on pay' was making management feel that they were working for shareholders.

There was great diversity of views as between voluntary/advisory/compulsory/intermittent 'say on pay' regimes. There needed to be harmonisation.

Although the evidence was mixed, there did not seem to be a trend where 'say on pay' reduced overall levels of remuneration. There was, however, perhaps more dialogue going on between shareholders and directors 'behind the scenes'. Thus, by the time the issue reached a meeting, a measure of agreement had been reached resulting in a vote in favour. Management was in a sense thereby protected by the vote.

Some questioned the value of EU wide legislation, was it too intrusive?

There was a strong view that banking sector remuneration structures encouraged excessive risk-taking and it was argued that restrictive legislation should only apply to financial institutions. The issue of financial sector pay was considered a highly political issue.

In the UK there was quite abundant evidence that shareholders in some recent cases were voting down remuneration policies. In the case of Aviva, the CEO had resigned because shareholders voted against his pay package on the grounds of his poor performance. Engagement by shareholders on this issue might encourage more engagement on other issues, especially where ownership was highly fragmented.

In Sweden, statutory and binding 'say on pay' had existed since 2006. However, the 'principles' had become standardised. The evidence seemed to show that when the decisions on pay were delegated from the board to members, a small majority could overrule a large minority in a way that was not done at board level. A governmental inquiry had proposed that the regime be returned to self-regulation.

On one view expressed, there was a danger of taking responsibility away from boards, for which this issue should be a 'core responsibility', and putting it onto shareholders. Shareholder engagement was not always necessarily a good thing for the company: see *Stock market turnover and corporate governance* by Alex Edmans, Vivian W Fang and Emanuel Zur, 16 February 2013 http://www.voxeu.org/article/stock-market-turnover-and-corporate-governance which uses American data.

Cross-border company law initiatives
It was generally felt that there was a need for wide consultation, but to be meaningful this would require more economic data.

Summing-up
Professor Becht suggested that there was more in the Action Plan than at first met the eye and that more meetings were needed to continue the debate.

SESSION 2: DIVERSITY ON BOARDS
Chaired by Professor Karin Thorburn, Professor of Finance, Norwegian School of Economics (NHH)

Introducing the session with slides (see Appendix 3), **Professor Thorburn** said that the session was intended to put into context the proposed directive on gender balance and the diversity proposals in the Action Plan. As a general theme, it was suggested that the evidence showed no causal relationship with performance, and therefore the issue was essentially one of gender equality.

Professor Thorburn identified both the monitoring and the advisory role of boards, and that although the literature shows that where a high fraction of women is on a board there is higher performance (stock returns, return on equity return on assets), there is no evidence of causality. The literature also appeared to show that female directors were more likely to join different 'monitoring ' committees of the board (e.g. audit, nomination) and there seemed to be a correlation between that heightened monitoring and increased CEO turnover. On the other hand in terms of share value, such increased monitoring was not reflected in enhanced share values - if anything, the reverse.

Professor Thorburn examined the performance characteristics of the boards of Norwegian companies (where there is a quota law) but again, it was not possible to discern a clear performance improvement as against pre quota performance. However, a study from Italy appears to show that a gender quota in politics increases the average level of education (in Sweden the average IQ levels of male politicians went up following political quota laws!).

Finally Professor Thorburn made the point that a recent study in the UK appeared to show that golf club membership was a better predictor of receiving a board position than a university degree. In the end, the issue of gender was more a question of whether we wanted the society we were living in to have equal influence on the economic power system.

Professor Paolo Giudici agreed that there was no clear evidence of any connection between there being more women on boards and performance, and that the issue was one of gender equality. He referred to a set of articles on corporate board gender diversity recently published in Volume 89 Issue 3 of the North Carolina Law Review 2011. Those articles cover the issue from many different angles and are worth reading. He questioned why legislation was being introduced which would affect only listed companies. If jurisdictions are really serious about the matter, legislation should apply to all companies.

Professor Maria Isabel Saez Lacave thought that boards around the world are under increasing pressure to choose directors that are independent, and directors that are female (gender diversity). Nevertheless, neither independence nor diversity is that valuable on their own without expertise. Gender politics have in this sense a positive effect: if females with business expertise should be considered part of the pool, corporations would benefit from a broader pool of talent from which to select their directors. But it can also have a negative effect: if the pool is small, the pressure to select women imposes further restrictions inside the pool. Expertise was the most important quality in a director and that this was a good way to pursue diversity: Diversity in itself was a good thing – it led to a less 'cosy' atmosphere. On the other hand, it is not clear in the empirical literature that gender diversity in the boardroom affects governance in meaningful ways. So, the push for less uniformity in the boardroom may be driven by social or ethical reasons, rather than better corporate governance or firm profitability.

General discussion

Two questions that arose on several occasions were: was the argument for diversity a business case or a moral case; and why was the debate limited to listed companies?

If, as per the evidence cited by Professor Thorburn, women on boards tended to be bigger risk-takers than men, there was a danger when quotas operated that the supply of able 'risk-taker' women might be exhausted rather quickly, leaving a pool of less qualified women.

It was also pointed out on several occasions that real power was in higher management and therefore the emphasis should be on 'getting it right' in terms of diversity at that level.

The view was expressed that 'we've been here before', namely on the issue of 'independent' directors where the same issues arose - not that there was nothing to do, but that legislation was not needed. 'Comply or explain' would allow greater diversity to happen.

The legislative background was Article 157 of the Treaty of Rome for the proposed Gender Quotas Directive; and Article 50 in relation to initiative on disclosure of diversity policy to be adopted. However, sanctions would need careful thought through.

Summing-up

Professor Thorburn concluded the session by observing that in her view although integrity was more important than expertise, it was not practical to list that virtue on a CV. She also congratulated Norway on making the quota an effective threat in forcing through change.

SESSION 3: SHORT-TERMISM - THE KAY REVIEW

Chaired by Professor Julian Franks, Professor of Finance, London Business School

Professor Mike Burkart commented that the Kay Review was somewhat difficult to navigate. It seems to suggest that everyone is 'short-termist'. For instance, in Chapter 1 (point 1.1), it states *"Short-termism, or myopic behaviour, is the natural human tendency to make decisions in search of immediate gratification at the expense of future returns….."* The phrase 'natural human tendency' implies that everybody suffers from it. The whole structure of the financial industry was about emphasising exit over long-term investment and this was why there was a lack of engagement. There was an accusation that boards listened too much to agents, but there is a good argument for saying that in fact they didn't listen enough. In his view, the Review's appeal to more group behaviour was not going to get anywhere.

Professor Maria Gutierrez Urtiaga agreed that the Kay Review could have usefully employed more clarity of direction. The Review was unclear as to how to persuade long-term investors to take the long-term view. Among the possible incentives, Professor Gutierrez Urtiaga favoured loyalty shares. More research was needed, in particular on the issue of whether the gains outweighed the costs.

Professor Fausto Panunzi observed that it was not clear what was meant by short-termism. There were many factors which might legitimately create a short-termist view. Share prices could sometimes be very 'noisy', thus influencing behaviour. Long-term performance required involvement by long-term holders. The desire for liquidity might militate against long-termism. Although the Review blamed the demands of asset management, short-termism might nevertheless be right in a given set of circumstances.

Professor Theo Vermaelen disagreed with most of the recommendations of the Review such as the abolition of short-term information, giving managers restricted stock. The crucial assumption made by John Kay is that the market is inefficient in the sense that it does not reflect expectations of long term cash flows. If the market is efficient, the distinction between long term and short term investors is irrelevant. If the market is efficient then stock prices will reflect the quality of corporate governance. This means that an investor can expect the same risk adjusted return in a high quality governance firm than in a low governance firm. Kay confuses market efficiency with perfect foresight: in an efficient market stock prices at time *t* reflect all available information at time *t*, not information that becomes only available at time *t+1*.

Professor Julian Franks observed that the Review did not demonstrate that long-term shareholding versus activism was of itself better. In relation to M&A activity, the evidence seemed to suggest that where shareholder approval was required, the outcome was more profitable than those deals where no consent was required.

General discussion

The general feeling was that there was an issue here which needed to be addressed but that the Review did not do it. The solutions offered were impractical and undesirable.

People tended to be optimistic about the future and that optimism was inevitably reflected in the stock markets. The objective in many countries was to preserve the company but regulation had been short-termist in nature – for example regulations in 2009 against 'shorting' the market.

The Commission indicated that it was also looking at incentives for long-term holding such as: loyalty shares enhanced voting rights, taxation options and increased dividends. The Commission also held the view that not all short-termism was negative; but how did one encourage investors to engage with boards also taking the long-term view? That was the difficult issue to resolve.

It was argued that the Commission should create enabling legislation which allowed companies to offer choices. Several voices asked: 'why regulate at all?'

Bonus shares for long-term membership militated against one-share-one-vote principle.

It was pointed out that the laws of several EU countries made the incentive suggestions illegal, but not in the UK or the US.

It was argued that more powers should be given on an EU wide basis to re-elect the board. There was much debate around the arguments for and against giving shareholders more powers to dispose of and appoint boards: some felt that this was the way to make boards more effective whilst others felt that this would detract negatively from the principle of board responsibility.

Summing-up
Professor Franks said that the central issue was how to encourage a position where there were more shareholders who have a long-term interest as well as the presence of short-term holders.

SESSION 4: BANK GOVERNANCE, REMUNERATION AND RESOLUTION
Chaired by Professor Colin Mayer, Peter Moores Professor of Management Studies, Said Business School, University of Oxford

Professor Colin Mayer introducing the session with slides (see Appendix 3) felt that there were clearly a number of issues for discussion: Bank governance and whether or not one should be thinking about changing the nature of the fiduciary responsibility of directors of banks; the capitalization of banks and the use of bail-ins; whether or not bailouts can be organized at lower cost than at present and avoid moral hazard problems; and finally, potential structural solutions and the extent to which competition should be encouraged or discouraged in banking and in that context the relevance of banks to ownership. Professor Mayer hoped that these issues could form the background to the discussion. He then introduced **Tom Snels** from the European Commission.

Tom Snels said that the Commission had adopted in July 2011 a proposal for a Directive [the Capital Requirements Directive – CRD IV] and a Regulation [CRR] which would replace the existing CRD III. CRD III included a set of principles which credit institutions must comply with when establishing and applying remuneration policies for “identified staff”, i.e. staff whose activities have a material impact on the risk profile of the bank and these are incorporated unchanged into CRD IV. They principles also reflect the Financial Stability Board principles for sound compensation. The substantive governance and remuneration provisions can be found in CRD4. The disclosure and transparency provisions as regards remuneration are laid down in the CRR (the Regulation). The proposed rules on corporate governance in CRD IV are new.

The CRD IV proposal contains the following key provisions:
- Art 75- Risk management;
- Art 86: Governance arrangements and details about the nomination committee;
- Art 87: Management body: including diversity and sufficient time commitment.

The Council had not yet reached agreement with the Parliament but it was hoped to reach agreement by March 2013. The issues under discussion included:
- Diversity in respect of which there were several divergent views;
- Role of the risk management function and its ability to report direct to the management body in its supervisory function; a limitation on the number of directorships;
- Pay: There was a need to combat excessive risk taking. On the fixed to variable issue, the Parliament thinks that the ratio should be one to one and was in discussion with the Council about that and as to whether shareholders should have the power to increase the ratio within certain limits.

Panel discussion
Professor Arturo Bris said it was necessary to address the different types of banks, and be clear about the kinds of banks we wanted for the future, risk takers willing to provide liquidity to the economy, or safe institutions with no economic value. On the topic of risk management, it was necessary to look at the management of risk once they materialize versus analysis of future risk. On the topic of remuneration, there was a concern that the European Parliament was imposing risk ratios. The Commission would not stop excessive bonuses and more ‘say on pay’ would not affect levels of pay.

Professor Peter Muelbert felt that Directors' fiduciary duties must look beyond shareholders. There were two other stakeholders: First, depositors/bond holders (one should facilitate debt holder engagement); and second, the government. Scepticism was felt about the view that shareholders would come in and change behaviours. CRD IV would not solve the next crisis.

Professor Mayer suggested that risk *management* was a way of trying to manage controlled risk taking.

Professor Christoph Van der Elst said that one could start from the premise that banks were different and the question was what kind of supervision did one want? One could organize that at different levels. There should be tight rules on thresholds of risk (e.g. repo) with opt outs. 'Bail-ins' were attractive but needed to be looked at in the context of who should run banks. He did not believe that 100% public ownership was the answer. Supervisors could be given much greater powers to, for example, write down debt, increase equity, require management to remove board members, appoint special managers and convert debt to equity. The ECB would not be a satisfactory supervisor since it was too conflicted. However, he was against these ideas because these were non market-led solutions. An innovative market led solution which had been suggested was the so-called 'CoCo' (Contingent Convertible) instrument for which the 'triggers' would not be ratio-driven but market-based. This would have made an early stage difference to capital structures. Reference was also made by **Professor Vermaelen** to the 'Call Option Enhanced Reversed Convertible' instrument: 'COERC', as a similar efficient market-led solution to capital structures which reflected the underlying risks. When a (market-led) trigger was hit, bonds would be converted at a deep discount to the market price. If the bond holders converted, they wiped out the equity holders. However, one would give shareholders the option to buy back the converted equity if they wanted to avoid dilution. Shareholders who could not afford to buy could sell their rights to the market. This might be said to create a credit spread which was not much higher than the 'risk-free' rate. Market-led solutions were better than bail-outs or bail-ins.

Professor Klaus Hopt said that academic evidence showed that banks were special and were different in a number of ways, including the principal/agent relationship; remuneration; boards; management (where evidence seemed to show that banks with more shareholder-friendly boards did worse in the crisis); and risk (where shareholder structures had an effect on risk-taking and, it seemed, that a high institutional presence resulted in worse performance in the crisis).

In risk evaluation, it should be remembered that banks had more stakeholders than most non-financial entities: for example, depositors who had no power; and large creditors who were secured so they did not see any need to step in. As for increasing the powers of supervisors, this would have the effect of weakening the independence of boards. Bail-ins could have a beneficial effect. 'Special Inquiries' had been shown in some jurisdictions to have resulted in prompt corrective action.

Professor Mayer suggested that maybe there needed to be a combination of actively engaged long-term shareholders or, in the case of banks, creditors.

The Commission's view was that the ideas expressed were very interesting; there was a need to study them carefully because of the risks of the unforeseen consequences of a given course of action. More research was needed.

Professor Hopt said that banks were different. He referred to a number of research papers over the years by, for instance, Fahlenbrach Beltratti, Stulz, Hopt, Wohlmannstetter, Mehran, Spong et al. and it had been stressed that bank structures in particular had become more opaque and complex than non-financial businesses. Moreover principal/agent conflicts in banks differed considerably from those in non-financial entities for all those involved - management, the board, shareholders, debt-holders, creditors and even supervisors.

Professor Hopt then examined each of these components. He also drew attention to the before-mentioned work by Fahlenbrach & Stulz, *Bank CEO Incentives and the Credit Crisis* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1439859 which seemed to show that where CEOs were given incentives aligned with shareholders, they performed worse than those without such incentives. He also pointed out that the evidence showed that banks had evaluated risk badly, yet banks whose boards were more ‘shareholder friendly’ performed significantly worse than banks with ‘non-friendly’ boards.

In that connection, he cited the paper by Beltratti & Stulz *Why Did Some Banks Perform Better during the Credit Crisis*? http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1433502 which raised the question as to whether bank governance was in fact a major cause of the banking crisis. He argued that the evidence would seem to show the negative influence of shareholders in the lead-up to the crisis. He also argued that strengthening official supervision weakened the independence of the board and the monitoring effects of stakeholders. For more details, see the recently published *Better Governance of Financial Institutions* http://ssrn.com/abstract=2212198 and, earlier, *Corporate Governance of Banks After the Financial Crisis* http://ssrn.com/abstract=1918851

Professor Alessio Pacces said there is a case for regulating the corporate governance of banks only if banking regulation alone is unable to police socially excessive risk-taking. One reason for this inability is that not all the risks are known and financial crises cannot be predicted. Two pieces of academic evidence counsel against direct regulation of corporate governance. First, banks that were more insulated from shareholders’ influence were less likely to need bailout. Second, a good predictor of bailout was how banks did in the previous crisis, showing the persistence of an unobservable risk-taking culture in financial institutions. Regulating the corporate governance of banks may require a radical change in approach. On the one hand, exclusive governance rights (e.g. appointment of directors; say-on-pay) could be conferred upon creditors that – via bail-in instruments – are credibly committed not to benefit from bailout. On the other hand, because short-term creditors of banks cannot credibly be excluded from bailout, the supervisory authority should also have corporate governance rights. However, in order to have the right incentives to exercise them, the supervisory authority should have the power to resolve a bank in trouble and bear the consequences of failing to do so timely. The EU project of a Single Supervisory Mechanism is largely incomplete in this perspective.

Points raised during the general discussion

CoCo’s and COERC’s were innovative solutions in the capital structures of banks.

There was much discussion on the powers of supervisors. Might they not include: the replacement of managers; the cancellation of shares; conversion of bonds into equity; and bail-outs against an approved business plan?

Other voices expressed reservations to the effect that these were entirely non market-led solutions; and in any event, the record of supervisors in the banking crisis was questionable to say the least.

Views were also expressed concerning powers which could be given the ECB to intervene. One view put forward was that bonds which would never require the taxpayer to bail-out the issuer could be regarded as tier one capital.

Summing-up

Professor Mayer acknowledged concerns if not scepticism expressed by the panelists about the role of corporate governance in relation to both the past failures and the future governance of banks. Aligning the interests of management and shareholders might not work for banks. There was a view that there should be a combination of fiduciary responsibilities and creditor enforcement as a way of introducing incentives for creditors to be involved. Bail-ins warranted more exploration. Finally, the suggestion that there should be more alignment of supervisors with risks to the system through central bank links should also be further researched.

Appendix 1: References

For Session 1: The European Commission Action Plan

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies COM(2012) 740/2 12 December 2012
http://www.ecgi.org/tcgd/2012/documents/121212_company-law-corporate-governance-action-plan_en.pdf

For Session 2: Diversity on Boards

Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on improving the gender balance among non-executive directors of companies listed on stock exchanges and related measures COM(2012) 614 final 14 November 2012
http://www.ecgi.org/conferences/eu_actionplan2013/documents/com2012_614_14nov2012_en.pdf

For Session 3: Short-termism – The Kay Review

The Kay Review of UK Equity Markets and Long-term Decision Making Final Report UK Department for Business Innovation & Skills July 2012
http://www.ecgi.org/conferences/eu_actionplan2013/documents/kay_review_final_report.pdf

For Session 4: Bank Governance, Remuneration and Resolution

Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate COM (2011) 453 final 20 July 2011
http://www.ecgi.org/conferences/eu_actionplan2013/documents/com2011_453_20July2011_en.pdf

High-level Expert Group on reforming the structure of the EU banking sector Final Report Chaired by Erkki Liikanen 2 October 2012
http://www.ecgi.org/conferences/eu_actionplan2013/documents/Liikanen_report_en.pdf

The Commission's proposals on Resolution and Crisis Management
http://ec.europa.eu/internal_market/bank/crisis_management/index_en.htm

Resolving Globally Active, Systemically Important, Financial Institutions
A joint paper by the Federal Deposit Insurance Corporation and the Bank of England 10 December 2012
http://www.ecgi.org/tcgd/2012/documents/nr156.pdf

For general background

See the ECGI website at http://www.ecgi.org/conferences/eu_actionplan2013/papers.php

Appendix 2: List of participants

ECGI Research members	
Professor Marco Becht	Professor of Finance and Economics, Université Libre de Bruxelles (ULB)
Professor Arturo Bris	Professor of Finance, IMD
Professor Mike Burkart	Gösta Olson Professor of Finance, Stockholm School of Economics
Professor Pierre-Henri Conac	Professor of Commercial and Company Law, Faculty of Law, Economics and Finance, University of Luxembourg
Professor Holger Fleischer	Director, Max Planck Institute for Comparative and International Private Law
Professor Julian Franks	Professor of Finance, London Business School
Professor Paolo Giudici	Professor of Business Law, Free University of Bozen-Bolzano
Professor Maria Gutierrez Urtiaga	Associate Professor, Department of Business and Finance, Universidad Carlos III de Madrid
Professor Klaus Hopt	Emeritus Professor, Max-Planck Institut fur Auslandisches und Internationales Privatrecht
Dr Stefano Lombardo	Assistant Professor of Economic Law, Free University of Bolzano
Professor Colin Mayer	Peter Moores Professor of Management Studies, Said Business School, University of Oxford
Professor Joseph McCahery	Professor of International Economic Law and Professor of Financial Market Regulation, Tilburg University Faculty of Law and Tilburg Law and Economics Center
Professor Peter Muelbert	Professor of Law, and Director of the Center for German and International Law of Financial Services, Johannes Gutenberg-Universität Mainz
Professor Alessio Pacces	Professor of Law and Finance, Rotterdam Institute of Law and Economics, Erasmus Universiteit Rotterdam
Professor Fausto Panunzi	Professor of Economics, Istituto di Economia Politica & IGIER, Università Bocconi
Professor Karin Thorburn	Professor of Finance, Norwegian School of Economics (NHH)
Professor Christoph Van Der Elst	Professor of Business Law, Tilburg University
Professor Theo Vermaelen	The Schroders Chaired Professor of International Finance and Asset Management, INSEAD
ECGI Board members	
Mr Leo Goldschmidt	Honorary Managing Partner, Bank Degroof
Ms Lisa Rabbe	Managing Director, Head of Public Policy – EMEA, Credit Suisse Securities (Europe) Limited
Ms Daniela Weber-Rey	Rechtsanwältin, Partner, Attorney at Law (New York), LL.M. (Columbia University), Clifford Chance
DG Internal Market and Services, European Commission	
Mr Jeroen Hooijer	Head of Corporate Governance, Social Responsibility Unit
Ms Joanna Sikora	Policy Officer, Corporate Governance, Social Responsibility Unit
Mr Tom Snels	Policy Officer, Corporate Governance, Social Responsibility Unit
London Business School Centre for Corporate Governance	
Mr Paul Coombes	Chairman, Centre for Corporate Governance, London Business School
Other invited guests and observers	
Mr David Devlin	Partner, PwC Dublin

Ms Pernilla Klein	Deputy CEO, SNS - Centre for Business and Policy Studies
Mr Per Lekvall	Member, Swedish Corporate Governance Board
Professor Maria Isabel Saez Lacave	Associate Professor, Department of Private Law, Universidad Autonoma de Madrid
Ms Ruta Steckiene	Attache, Permanent Representation of Lithuania to the EU
Mr Conor Verdon	Company Law, Department of Jobs, Enterprise and Innovation, Ireland

The European Commission Action Plan on Company Law and Corporate Governance

22 January 2013

European Commission
Thierry Stoll Room, 2, Rue de Spa, 1000 Brussels

(The Plan has EEA Relevance)

Programme for the day

9.15	Session 1 – Action Plan
10.30	Session 2 – Board Diversity
11.00	Coffee
11.15	Session 3 – The Kay Review
12.30	Lunch
14.00	Session 4 – Bank Governance

Session 1 – The Action Plan

Chaired by: Marco Becht

Presenters: Pierre-Henri Conac, Joe McCahery

Session 2 – Diversity on Boards

Chaired by: Karin Thorburn

Presenters: Paolo Giudici, Maria Isabel Saez Lacave

Session 3 – The Kay Review

Chaired by: Julian Franks

Presenters: Mike Burkart, Maria Gutiérrez Urtiaga, Stefano Lombardo, Fausto Panunzi, Theo Vermaelen

Session 4 – Bank Governance, Remuneration and Resolution

Briefing: Tom Snels, DG Markt
Session chaired by: Colin Mayer

Presenters: Arturo Bris, Christoph Van der Elst, Holger Fleischer, Klaus Hopt, Peter Muelbert, Alessio Pacces

Session 1 – The Action Plan

Chaired by: Marco Becht

Presenters: Pierre-Henri Conac, Joe McCahery

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The Structure of the Plan

1. Introduction
2. Enhancing Transparency
    1. Disclosure of board diversity and management of non-financial risk
    2. Improving corporate governance reporting
    3. Shareholder identification
    4. Strengthening transparency rules for institutional investors
3. Engaging Shareholders
    1. Better oversight of remuneration policies
    2. Better oversight of related party transactions
    3. Regulating Proxy Advisors
    4. Employee share ownership
4. Cross-Border Company Law
5. Codification

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Section 2 – Enhancing Transparency

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Section 4 – Improving the Framework for Cross-Border Operations

1. Transfer of seat
2. Improving the mechanism for cross-border mergers
3. Enabling cross-border divisions
4. Smart legal forms for European SMEs
5. Promoting and improving awareness of the European Company (SE) and the European Cooperative (SCE) Statutes
6. Groups of companies

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Section 5 – Codification of EU Company Law

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Session 2 – Diversity on Boards

Chaired by: Karin Thorburn

Presenters: Paolo Giudici, Maria Isabel Saez Lacave

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COMMENTS ON THE DIRECTIVE ON IMPROVING THE GENDER BALANCE AMONG NON-EXECUTIVE DIRECTORS OF LISTED COMPANIES

Professor Karin S. Thorburn, Norwegian School of Economics
Discussion at the ECGI-European Commission Workshop
Brussels, January 23, 2013

The directive in brief

- Each gender should hold at least 40% of the non-executive director positions of listed firms
- Firms failing to meet the 40% requirement should select directors
  - Based on an objective, comparative analysis of the qualifications of each candidate
  - Using pre-established, clear, neutrally formulated and unambiguous criteria
  - If equally qualified, priority should be given to the underrepresented sex
- An unsuccessful candidate may require disclosure of the criteria, comparative assessment, and consideration tilting the decision
- Firms should provide information about the gender representation on their boards and intended actions yearly

Key questions

- Are gender balanced boards a way to improve corporate performance or simply a gender equality issue?
  - The role of the board
  - Evidence on women on boards
  - The Norwegian board gender quota
  - Quotas in politics
- Is regulatory action necessary to obtain gender-balanced boards?
  - Will the board gender-balance change without regulation?
- Will the directive succeed in changing the gender-balance on boards of listed firms in Europe?
  - Is “comply or explain” enough to enforce change?

Board room gender quotas in Europe, 2012

Country	Year passed	Quota size	Year of compliance	Sanc-tions	% female directors
Norway	2003	40%	2008	yes	42%
Spain	2007	40%	2015	no	11%
Iceland	2010	40%	2013	yes	25%
France	2011	40%	2017	yes	22%
Belgium	2011	33%	2019	yes	11%
Netherlands	2011	30%	2016	no	19%
Italy	2011	33%	2015	yes	6%
European Union	Legislative proposal: 40% gender quota				14%

The role of the board of directors

- Monitoring vs. giving advice
- Outside vs. inside directors
  - More independent, but less informed about the firm
- CEO turnover is more sensitive to firm performance when
  - The board is dominated by outside directors (vs. insiders)
  - The board is relatively small
  - Directors have equity incentives
  - The CEO is not Chairman of the board
- Board characteristics and firm performance
  - Near impossible to attribute causality
    - Do certain firms chose certain boards?
    - Or do board characteristics affect firm performance?

Female directors and firm performance

- Several studies find a positive relationship between fraction female directors or top executives and firm performance
  - Stock returns, ROE, ROA, ROIC, sales growth, etc.
- But it is impossible to make any inferences about causality
  - Are profitable firms more likely to appoint women?
  - Or do women prefer directorships in profitable firms?
- Similar issue with studies that find a correlation between gender diversity and CSR, CER, or better management practices
- Little ground for claims that adding women to the board will improve firm performance

Valuation effect of female directors (Adams, Gray and Nowland, 2011)

- Shareholders seem to value voluntary appointments of female directors more than appointments of male directors
  - Study of mandatory announcements of new outside director appointments in Australia, 2004-2006
  - Stock price reaction significantly higher on the announcement of female directors (approx. 2%), controlling for director characteristics
  - Similar results exist for firms in Spain and Singapore
- Firms that appoint female directors have bigger and more diverse boards, and more equal opportunity practices

Are female directors better monitors? (Adams and Ferreira, 2009)

- Gender-diverse US boards allocate more effort to monitoring
  - Female directors have better attendance records
  - Male directors have better attendance in gender diverse boards
  - Female directors are more likely to join monitoring committees
    - Audit, nominating, corporate governance
- The monitoring of gender-diverse boards is manifested in higher performance-sensitivity of CEO turnover
  - And a higher likelihood of equity-based board compensation
- Gender diversity increases firm value in firms with weak shareholder rights (where monitoring is valuable)
- But it reduces the value of firms with strong shareholder rights
  - Could there be too much monitoring?

Gender spillover from the board to top management (Matsa and Miller, 2012)

- Female representation on corporate boards seem to affect the gender composition of the top management
- Firms with more women directors on the board have more female top executives
  - The previous year's female share of directors predicts the fraction females in top management, but not the reverse
  - Changes in board composition precede changes in executive membership
- Could reflect different preferences of the board
- Or a corporate culture that attracts female top executives

History of Norwegian quota and stock market reaction (Eckbo, Nygaard and Thorburn, 2012)

Date	Event	% women	Average return	Cumul. return
1999-10-15	Public hearing: 25% board quota	3%	-0.48%***	-0.48%***
2001-07-02	Public hearing: 40% board quota	4%	-0.03%	-0.51%***
2002-02-22	News interview: minister supports quota	5%	-0.78%***	-1.29%***
2002-03-08	Government asks private sector to add women voluntarily	5%	0.64%***	-0.65%*
2003-06-13	Law proposal presented	7%	-0.33%**	-0.98%**
2003-11-27	Law passed. Voluntary compliance by 2005 will void the law	7%	0.48%***	-0.50%
2005-12-09	Law is mandated with forced liquidation as sanction	15%	0.25%*	-0.25%

Board characteristics of Norwegian firms (Ahern and Dittmar, 2012)

	2002	2006	2009
Number of directors	5.5	5.6	5.3
Female (%)	7%	29%	43%
CEO experience (%)	65%	59%	58%
Higher education (%)	26%	28%	29%
Age (years)	51	51	52
Tenure (years)	3.0	2.3	2.6
Norwegian (%)	93%	92%	90%
Board or CEO positions per person	1.4	2.3	1.9

Director characteristics of Norwegian firms (Ahern and Dittmar, 2012)

	Female		Male	
	New	Exiting	New	Exiting
Age	46	48	50	53
CEO experience	31%	36%	64%	65%
University degree	33%	30%	19%	23%
Primary outside occupation:				
CEO	16%	20%	28%	26%
CFO	7%	9%	5%	3%
VP	13%	14%	7%	5%
Non-executive manager	15%	14%	5%	5%
Consultant	14%	9%	10%	10%

Do outside CEO directors add value? (Fahlenbrach, Low, and Stulz, 2010)

- Positive stock-price reaction when the first CEO outside director is appointed (vs. other outside directors)
  - But not for additional CEO-director appointments
- The appointment of a CEO outside director is not followed by improved operating performance
  - No increase in performance-sensitivity of CEO turnover
  - No improvement of acquisition announcement returns
  - No change in CEO compensation policies
- Performance drops when the CEO-director is interlocked
  - Interlocks reduce CEO turnover for well-performing firms, suggesting that "life is good"

Are female directors "busy" directors

- Total number of board memberships for directors of Norwegian listed firms, July 2012

Number of directorships	% of female directors	% of male directors
One board role	83%	89%
Two-three board positions	15%	10%
Four or more board positions	2%	1%

- Female directors are often "independent" directors
  - 84% vs. 50% of male directors

The board reform and corporate decisions (Matsa and Miller, 2011)

- Study comparing Norwegian quota firms to similar firms in Scandinavia or private firms not subject to the quota
- The quota firms failed to reduce the work force relative to comparable firms after the quota (2003-2006 vs. 2006-2009)
  - Quota firms undertook fewer workforce reductions
  - Relative increase in employment levels and labor costs
  - Relative decline in operating profitability (ROE)
- Strongest effects for boards adding the most women
- Greater effect on corporate strategy for boards appointing a new CEO after the quota
  - After quota, 5% of CEOs were female (vs. 0% before quota)
- Are female directors are more altruistic?

Female directors seem more stakeholder oriented (Adams and Funk, 2011)

- Survey of all directors of publicly listed firms in Sweden in 2005
  - Established survey (Schwartz PVQ)
  - Shown to successfully predict economic behavior
- Female directors report significantly different core values than their male colleagues
  - Care less for power and achievement
  - Are more benevolent and universally concerned
  - Are more independent minded
    - Value independence, stimulation and change more
    - Value tradition, conformity and security less
  - Are slightly more risk-loving (!)

Valuation effects of the Norwegian quota

- Ahern and Dittmar (2012) finds that market-to-book ratios dropped over time for firms that had to add more female directors
  - However, controlling for director characteristics such as age and CEO experience, this difference disappears
- Many non-listed firms changed legal form (Bohren and Staubo, 2012)
  - In particular, small, young, profitable firms with concentrated ownership and few (if any) women on the board
  - Was this because the quota destroyed value?
  - Or was it initiated by male dominated boards avoiding change?
- Overall, difficult to conclude that the reform had any long-term valuation effects

Gender quotas in politics

- Increases female representation in political bodies
  - This increase lasts over time
- Help change attitudes and break down negative stereotypes
  - Lasting effect after termination of quota
- Leads to different policy outcomes
  - Increased investments in goods favored by women, such as drinking water and other public goods
  - Less political corruption and bribes
- Improves the quality of the politicians
  - Increase in average level of education
  - Increase in average IQ of male politicians

Should board gender quotas be imposed?

- Inconclusive evidence as to whether adding women to the board really increases firm value
- This makes a board gender quota a purely political issue and a gender equality issue
  - In Norway, the quota was proposed by the Ministry for Children, Family and Equality
- Do we want a society where women has equal influence and economic power as men?
  - In the UK, a golf club membership is a 4 times better predictor of receiving a corporate board position than a top university education
  - So far, little change without legal action
  - In my mind, there is only one answer to that question

Bank Governance, Remuneration and Resolution

Colin Mayer

Proposals

- Corporate Governance
- Capital Requirements
- Resolution
- Structural Solutions

Corporate Governance

- Failure to monitor, measure, manage risks
- Recommendations regarding:
  - Boards: appointment, diversity, commitment, independence
  - Risk and Remuneration: control of risks, auditing, executive remuneration
  - Shareholder Engagement: stewardship by shareholders

Micro-Governance as Source of Systemic Failure

- Potential systemic consequences arising from problems of:
  - Identification
  - Unintended consequences
  - Homogeneity
- Relation of corporate governance and executive remuneration to bank performance and risk taking
- Should directors have fiduciary responsibility to creditors?

Capital Requirements

- Admati, De Marzo, Hellwig and Pfleiderer – low costs, high benefits of equity
- Miles – capital requirements double current proposals
- Debt overhang – withdrawal of lending
- Bail-ins and contingent debt contracts

Resolution

- Bail-outs – Iceland, Ireland and Lehman Brothers experiences
- Moral hazard
- Contrast with Swedish bank experience
- Lower cost forms of resolution
- FDIC – Bank of England accord
- Risk of absence of explicit guarantees

Structural Solutions

- Ring-fencing of retail versus investment banking or separation of trading from the rest
- Implications for social value of different parts of financial system and the functions that banks are supposed to perform
- Competition in banking and charter values
- Relevance of bank ownership

Issues for Discussion

- Are proposals for bank governance, boards, remuneration, engagement, fiduciary responsibility appropriate?
- Should capital requirements be raised and should greater use be made of bail-ins?
- Can bail-outs be effectively organized at low cost?
- Are proposed structural solutions appropriate, should competition be encouraged, and how relevant is bank ownership?