European Trade Union Confederation (ETUC)
Confédération européenne des syndicats (CES)

Response of :

European Trade Union Confederation

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Consultation on the Green Paper on

"An EU Framework for Corporate Governance"

European Commission

DG Internal Market

1. Name of your legal entity, organisation, or service, its legal form, country of origin, size (if enterprise i.e. micro, small etc) and field of activity. Please indicate your function

The ETUC was founded in 1973 to defend the interests of workers at European level and to represent them before EU bodies.

(a) Objectives

The European integration process, with the euro, the European Constitution and the growing impact of European legislation on day-to-day life, has changed the setting within which trade unions operate. To defend their members and negotiate effectively on their behalf at national level, they must co-ordinate their activities and policies at European level. To exert an influence on the economy and society at large, they have to speak with a single voice and act collectively at European level. That is why the ETUC exists.

(b) Composition

The ETUC presently counts 81 member organisations from 36 European countries, along with 12 European industry federations, or over **60 million members**, as well as organisations with observer status in Macedonia and Serbia. Other trade union structures such as EUROCADRES (Council of European Professional and Managerial Staff) and EFREP/FERPA (European Federation of Retired and Elderly Persons) operate under the auspices of the ETUC. In addition, the ETUC co-ordinates the activities of the 39 ITUCs (Inter-regional Trade Union Councils), which organise cross-border trade union co-operation.

The ETUC is one of the European social partners and is recognised by the European Union, the Council of Europe and the EFTA as the only representative multi-sector trade union organisation at European level.

(c) The ETUC is the European social partner that represents workers

At the same time, the ETUC negotiates **with employers** through "European social dialogue" . This translates into sectoral social dialogue in 31 different industrial sectors, co-ordinated by the **European industry federations.** Finally, the ETUC is the only European organisation representing all workers in Europe in the cross-sectoral Social Dialogue Committee. Social dialogue is the cornerstone of the ETUC's action.

The European trade union federations affiliated to the ETUC are also major players in the social dialogue set up in European sectoral joint committees.

Following formal EU recognition of the social partners' right to negotiate framework agreements at European level, the ETUC signed three **European framework agreements** with its employer counterparts, which were adopted by the Council of Ministers and implemented as Directives. These concern parental leave (1996), part-time work (1997) and fixed-term contracts (1999). The unions and employers have also implemented European-level agreements concluded under "autonomous" social dialogue on **teleworking** (2002) and **work-related stress** (2004). Finally, different frameworks have been signed, including **the**

frameworks of actions for the development of lifelong skills and qualifications (2002) and **on gender equality** (2005).

The ETUC's objective is to give a strong social dimension to the European Union guaranteeing the welfare of all its citizens.

The European Trade Union Confederation is more specifically mandated to take actions to attain its objectives in areas such as employment, social affairs, macro-economic policy, the Internal Market, industrial policy, regional policy, the environment, enlargement and the European neighbourhood policy. It also has the task of enforcing applicable social standards and rights in the Union. The ETUC also co-ordinates union participation in different advisory bodies, including the European Agencies for Vocational Training (CEDEFOP), for Improvement of Living and Working Conditions (the Dublin-based foundation) and for Safety and Health (in Bilbao).

ETUC response to the European Commission Green Paper on "The EU corporate governance framework"

Introductory Remarks

The failure of the corporate governance framework in Europe and elsewhere is one of the primary causes of the current financial and economic crisis. Companies (both in the financial and nonfinancial sectors) have taken on too much risk and debt and neglected long-term investments in workforce skills and innovation. Investors and managers have become too oriented towards short-term gains, in many cases achieving these gains through questionable or fraudulent means. Takeovers have been executed by many companies and encouraged by many investors, even though most takeovers do not add value in the long run. Citizens are becoming more doubtful of the morality of business leaders and are losing confidence in the economic system.

The current corporate governance framework is in large part the result of decades of changes in the corporate governance framework which were informed by a misguided model, the so-called "shareholder value" model. This approach, which claims that the main problem in corporate governance is to ensure that managers work in the interests of shareholders, has advocated the introduction of a set of mechanisms, including: share-oriented remuneration for top managers, greater rights for minority shareholders, removing barriers to hostile takeovers, increasing the role of independent directors and increased transparency in board affairs.

However, these changes have by and large not led to the positive results that were promised by "shareholder value" advocates, but rather to the negative outcomes indicated above. This is because the model was based on flawed assumptions about the way the economic system and managers operate. Since an increasing number of investors are short-term and do not play an active role in corporate governance, increased minority shareholder rights open the field for "activist" investors. These investors can, with relatively small stakes, make short-term gains through pressuring management to make one-off changes (such as depleting their accumulated cash) or (when on the short side) by spreading negative rumours. Share-based compensation has not been the panacea leading to long-run value creation, but instead has led many managers to pursue risky short-term strategies. Abundant liquidity has led to an under-pricing of risk and capital, encouraging leveraged buyouts and takeovers which make no sense in the long-term. Market prices do not reflect the costs of environmental damage or the neglect of human resources since many of these costs are carried by society rather than companies.

This situation requires a fundamental change in the corporate governance framework. Companies need to be reoriented towards sustainable long-term value creation. This will involve major changes in a whole set of elements of the corporate governance framework. Management remuneration needs to be oriented towards sustainability, for example by basing variable pay on employee satisfaction and company progress in reducing environmental damage. The framework for shareholding needs to be transformed so that investors focus on long-term responsible investment in sustainable company strategies, rather than betting on short-term speculative gains or pressuring managers to take one-off actions. Boards need to become more diverse and represent a broader set of interests than those of managers bent on empire-building or a small set of shareholders. Companies need to report on not only financial performance but also on ecological and social impacts.

The Green Paper has neglected the particularly important role in corporate governance that can be played by workers and the strengthening of worker “voice” through a variety of mechanisms. One such mechanism is through board level employee representation. A majority of EU Member States have legal provisions for board level employee representation for a portion of their companies, and many European Companies (SEs) have worker participation arrangements; worker participation has played a positive role in sustainability, innovation and reducing the impact of restructuring. However, this is not the only mechanism for exercising worker voice. Over 900 European Works Councils are currently in existence, and important matters such as restructuring and sustainability are discussed in EWC meetings with top management. A number of companies have negotiating International Framework Agreements with their workforces, and some of these include sustainability issues. More and more companies are engaging workforces and their representatives in stakeholder dialogues. All these mechanisms for worker voice to be strengthened as a counterbalance to the short-termism which is endemic in the current system. The ETUC demands European minimum standards for worker participation in order to strengthen the implementation of worker information and consultation rights in the EU and to confirm that the EU respects and promotes different forms of board-level representation in European legal entities like SE, SCE and SPE and in the Member States where such systems exist.

General questions

(1) Should EU corporate governance measures take into account the size of listed companies? How? Should a differentiated and proportionate regime for small and medium-sized listed companies be established? If so, are there any appropriate definitions or thresholds? If so, please suggest ways of adapting them for SMEs where appropriate when answering the questions below.

EU corporate governance measures should not just apply to large listed companies. Given the involvement and legitimate interest of employees and other stakeholders in all types of companies, corporate governance principles should apply to both listed and unlisted companies and of all sizes. Although there may be a case for less stringent reporting requirements for very small companies, the threshold must be set very low (in terms of number of employees) so that companies do not use cost arguments as an excuse for avoiding legitimate obligations. Thresholds for worker involvement in many countries are quite low (e.g. 25 in Sweden for worker board level representation participation) and corporate governance principles should apply to these types of companies as well.

(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?

Unlisted companies should also be subject to corporate governance measures and required to improve their disclosure of information, including information on non-financial (environmental and social) impacts, and to respect stakeholder rights. Voluntary codes have by and large proved to be ineffective in corporate governance matters. Such measures should therefore be mandatory.

Boards 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?

The separation of the functions and duties of the chairperson and the chief executive officer (CEO) have had some positive results in discouraging “empire building” by CEOs. Two-tier board systems have a long history of effective supervision of full-time managers. Measures requiring or encouraging this separation in countries with one-tier boards have also had positive experiences in reducing the concentration of power in the hands of one manager. In general the ETUC supports the principle of separation of duties. The entire board should be involved in strategic decision making and members of the board should not be discriminated against regarding their rights (e.g. to access to company information).

(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?

As a general principle it is desirable that boards have an adequate mix of experience, skills and diversity among their membership. Most company boards are not diverse enough and many directors lack important skills needed to decide on strategy and monitor companies. Companies need to be more explicit about the skills their directors should have. It is particularly important that the profile of the overall board includes different backgrounds and competences and is not recruited exclusively from “old boy” elite networks. Studies show that the functioning of boards can be improved by including persons with different backgrounds, experiences and roles.

The ETUC particularly wants to stress measures to ensure diversity in the composition of the board of directors. The functioning of boards can be improved by including more women and persons with different backgrounds, experiences and roles. Employee representation on company supervisory boards is one way of ensuring that persons from different backgrounds are included. As a matter of principle the ETUC believes that companies should specify their director profiles, however, the question of mechanisms used and the level of regulation needs further examination.

(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.

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

Yes. Commissioner Viviane Reding has recently launched the initiative "Women on the Board Pledge for Europe", which represents a voluntary commitment by publicly listed companies to increase women's presence on corporate boards to 30 per cent by 2015 and to 40 per cent by 2020. The ETUC supports this initiative, but would like to note that voluntary approaches have not proven to be very successful in the past. Therefore, the Commission should consider introducing binding measures if companies do not improve the gender balance on boards.

(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?

In principle the number of mandates that non-executive directors may hold should be limited. Companies cannot be properly monitored by non-executive directors that have too many mandates. Diversity is also limited if a small number of directors hold a large number of mandates. This should also clearly apply to executive directors holding non-executive director positions in other companies. In principle the ETUC supports limiting the number of mandates, however, the questions of the appropriate level of regulation and burdens of different types of mandates need further examination.

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

It is useful for companies to commission regular evaluations of their operations. This should however apply to executive as well as non-executive (supervisory) boards equally in two tier systems. The results of the evaluations should be discussed internally rather than made available externally, so that the evaluators will not be discouraged from writing honest and critical reports.

(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. This requirement should be clear about how policy and individual remuneration be reported (i.e. which components are reported, how they are reported, how detailed policy should be, etc.). This report should also be very clear about what (if any) sustainability elements are included in remuneration (e.g. tying a portion of management pay to employee satisfaction, the improvement of occupational health and safety, etc). Companies should also be required to disclose the ratio of top executive remuneration to the pay of average and low wage workers in the company. Increased transparency in remuneration may be a mechanism for exposing the gender pay gap among executives.

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

As shown by the experience of countries where remuneration policy and the remuneration report are put to a vote by shareholders, such shareholder voting rights have proven effective in a number of cases in reducing excessive remuneration packages. Such a requirement is therefore welcomed for companies with monistic board systems and for the remuneration of supervisory board members of companies with dualistic board systems. However, in the case of management boards in companies with strong worker participation on the supervisory board, the experience of Germany has shown that a non-binding shareholder vote on executive directors suffices.

(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 in both cases.

(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.

<u>Shareholders</u>

(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 current EU merger regime is inadequate in discouraging takeovers which may lead to short-term increases in share price but do not add value for either stakeholders or shareholders in the long run. The merger control regime should take into account of the potential for "stakeholder" value creation. Since hostile takeovers also generally do not lead to long-term value creation, the takeover regime should be tightened up to discourage hostile takeovers.

(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?

One of the unfortunate manifestations of short-termism is that even investors with a capacity to invest long-term (e.g. pension funds and insurance companies, which have a high capacity to calculate their long-term income and liabilities) have for the most part become short-term investors. Many pension funds outsource their asset management to a number of investment managers, and will frequently replace the lowest-performing manager, putting pressure on these managers to maximize annual returns. Incentive structures also encourage most investment managers to focus on relative value (i.e. performance relative to a benchmark) instead of absolute value creation.

The incentive structures of asset managers need to be modified to take into account a broader set of measures, including risk, volatility and absolute value creation, and transparency of these measures should be improved. One measure to realize this would be to clarify "prudent investor" rules so that these broader measures are taken into account in evaluating asset managers. This should include the extent to which they take into account the investment risks that companies with substandard environmental and employment practices represent.

(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?

EU law should require increased transparency on the part of asset managers, both vis-à-vis institutional investors and the public, with regard to their fees, costs, strategies, turnover rate of assets, leverage, and responsible investment policies. One possible mechanism to do this would be in an annual report filed with the EU and made available on the asset managers' website.

(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?

EU rules should require a great degree of independence of asset managers' governing bodies from their parent bodies as well as disclosure of conflict of interest.

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

A first step would be for the EU to provide clear rules regarding legal forms of shareholder cooperation. These rules should be designed in a manner which encourage cooperation between long-term responsible investors but at the same time discourage cooperation between short-term oriented investors seeking to pressure management for short-term gains.

(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?

EU law should require proxy advisors to be transparent on their analytical methods, for their policies for dealing conflicts of interests and on their actual cases of 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?

Legislative measures are needed to reduce the potential for conflicts of interest by proxy advisors. These proxy advisors should not be allowed to provide consulting services to the companies on which they are supposed to provide investment advice.

(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).

A European mechanism for identifying shareholders would be desirable. This should identify not only investors holding shares of at least a certain level (e.g. above three percent) but also investors with significant short positions and also "hidden ownership." This mechanism should provide transparency to identify investors with interests opposed to the long-term sustainability of the company as well as encourage cooperation between investors with such long-term interests.

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

Currently the problem of minority shareholders exploiting the passivity of other shareholders or other mechanisms to pressure management for short term gains is at least as large as the problem of minority shareholders being exploited by controlling or dominant shareholders. A more important problem is protecting and strengthening the rights of workers and other stakeholders with a long-term interest in the company vis-à-vis both minority and dominant shareholders.

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

Disclosure requirements on related party transactions as well as penalties for non-compliance should be strengthened.

(23) Are there measures to be taken, and is so, which ones, to promote at EU level employee share ownership?

Although employee financial participation (EFP) offers opportunities for businesses, employees and society as a whole to participate in the increasing Europeanization of economic activity at the same time caution must be exercised with regard to the characteristics and modalities of EFP. EFP must be introduced voluntary and neither be a substitute for existing remuneration system nor impede collective bargaining. The opinion on "Employee financial participation in Europe" (SOC/371 adopted 21 Oct 2010) by the European Economic and Social Committee (EESC) offers a comprehensive basis for approaching this issue. It outlines ten measures for adoption at the EU level, including making EFP subject to collective bargaining (where this exists), ensuring that EFP does not replace wage progression, and doing further research on and identification of best practice in EFP.

<u>Monitoring and implementation of Corporate Governance Codes</u>

(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?

As demonstrated by the RiskMetrics 2009 "Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States", codes based on the "comply or explain" principle have not been very effective in encouraging corporate governance "best practice" or disclosure. Both monitoring bodies and investors have failed to penalize companies that provide little or no explanation for lack of compliance with codes. The ETUC demands a binding legal basis for corporate governance principles. However, where it is not politically feasible to replace codes with binding legislation, codat the very least, codes should at least include specifications for what is considered an adequate explanation as well as penalties for lack of adequate explanations.

(25) Do you agree that monitoring bodies should be authorised 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?

As elaborated in the answer to the previous question, the ETUC prefers a binding legal basis for corporate governance principles to codes. Where corporate governance principles are defined in law, mechanisms for enforcement and sanctioning should exist. However, where codes exist and a binding legal basis is not feasible, monitoring bodies should be authorized to check the completeness and quality of corporate governance statements and impose or recommend penalties for non-compliance.

European Trade Union Confederation
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