

# RECENT DEVELOPMENTS IN CORPORATE GOVERNANCE FROM A EUROPEAN PERSPECTIVE

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Athens, 11 October 2018

Corporate Governance conference



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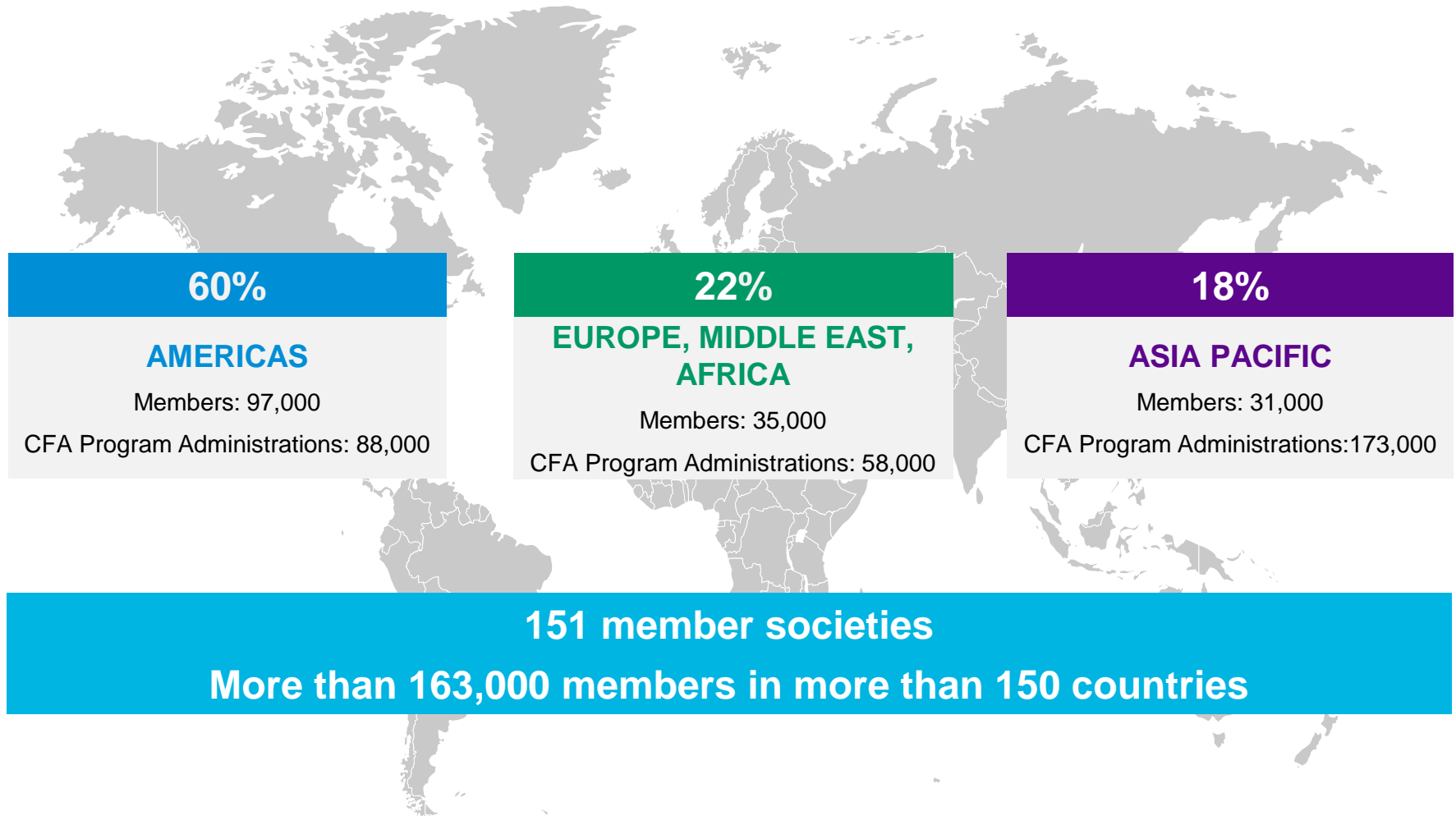
# OUR MISSION



**To lead the investment profession globally**

by promoting the highest standards of ethics, education,  
and professional excellence for the **ultimate benefit of society.**

# GLOBAL INFLUENCE TODAY



Member data as of August 2018; CFA Program for FY18; numbers rounded

# REFORM PROCESS MOMENTUM

# SHAREHOLDER RIGHTS DIRECTIVE (SRD) II

## Where has SRD II brought us?

- The new SRD seeks to enhance shareholder rights, but also encourages more long-term focus in corporate governance and shareholder engagement
- New directive adopted in 2017 setting out specific requirements to encourage shareholder long-term engagement and increase transparency.
- These requirements apply to:
  - Remuneration of directors;
  - Identification of shareholders;
  - Easier exercise of shareholders' rights;
  - Transmission of information;
  - Transparency for institutional investors, asset managers and proxy advisors;
  - and related party transactions.

# REFORM PROCESS MOMENTUM

## **DG FISMA & DG JUST**

- The Governance of the corporation is now as important in the world economy as the government of countries (Wolfensohn, Former head of the World Bank).
- Commission should consider how further Governance policy work might integrate with the CMU, to address investors concerns about their rights in European Companies with controlling shareholders.
- Transition may mean a drift away from seeing governance as a lever in economic policy towards a view in which social issues may take a higher profile.

# NEW EXPERT GROUP ON TECHNICAL ASPECTS OF CORPORATE GOVERNANCE

- This group provides technical advice on corporate governance aspects related to listed companies, including the use of modern information and communication technologies in corporate governance.
- Discussions on:
  - Need for a better, structured and more meaningful information on remuneration throughout Europe (possible common standard structure of a remuneration report);
  - Possible guidance on what is to be considered fixed and what is to be considered variable remuneration;
  - Disclosure of specific performance targets (but only ex-post as ex-ante disclosure of targets is seen as a disclosure of business sensitive information);
  - General information on the “malus” and claw-back regimes to be described in the remuneration policy and not in the remuneration report.

Source: European Commission, 2018

# CORPORATE GOVERNANCE – THE CASE OF SNAPCHAT IPO

- How far are shareholders willing to chase gains in exchange for their votes?
- Snap is setting a dangerous precedent and it represents a setback for investor protection and corporate governance.
- Snap opened at US\$24/share on 2 March, but despite a 44% pop on the first day of trading, the shares dropped 17% to below \$20 a week after.
- The founders are keeping a 22.4% stake each in Class C shares which have 10 votes each and give the founders 88.5% of voting power.
- Other companies with dual-class structures have failed to offer long-termism (l.e. Groupon, Zynga).



# CFA INSTITUTE'S CORPORATE GOVERNANCE REPORT

# CORPORATE GOVERNANCE REPORT

- EU has been pursuing a policy of strengthening company boards, increasing information flows, and encouraging institutional investor oversight.
- However, following the completion of the revised Shareholder Rights Directive (SRD II), which was characterized by a series of arguably “disparate” initiatives, the future governance agenda in Europe still lacks clarity.
- CFA Institute commissioned this project to examine the state of corporate governance policy and practices in Europe and to articulate a constructive investor’s perspective on the development of governance policy and practice.
- Our findings were developed on the basis of:
  - Three half-day workshops with 30 investors & governance professionals who have responsibility for governance oversight.
  - Interviews with leading European institutions

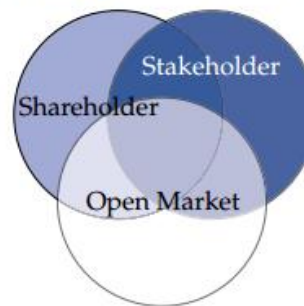
# 'SWEET' SPOT?

**Figure 1: Three Perspectives: Shareholder Primacy, Stakeholder, and Open Market**

## *A. Perspectives in Conflict?*



## *B. Perspectives Aligned?*



# INSTITUTIONAL INVESTORS' PERCEPTION

## Investor stewardship

**Table 2. For the Competing Propositions X and Y, Which Best Reflects the Group's Own View?**

Proposition X	Strongly prefer proposition X to proposition Y	Tend to prefer proposition X to proposition Y	Tend to prefer proposition Y to proposition X	Strongly prefer proposition Y to proposition X	Proposition Y
Stewardship is a nice idea. But institutional shareholders have only limited resources to carry out that function. You can't place too much burden on them.	●	●	●   ●	● ● ● ●	Companies need owners. Institutional shareholders can and must fill the ownership gap. They probably need to do more.
Institutional shareholders have a role to play; but realistically, it is a limited one. The burden must rest with boards and with others in the governance system: auditors, regulators, media, and so on.	●	●	● ●   ● ●	●	Institutional shareholders are the only group which can hold companies to account. Others play important roles, but investment institutions are a cornerstone and must devote resources to this task.

● Individual Observation — Workshop Average

# INSTITUTIONAL INVESTORS' PERCEPTION

## 'Comply or Explain' vs Hard Law

**Table 3. For the Competing Propositions X and Y, Which Best Reflects the Group's Own View?**

Proposition X	Strongly prefer proposition X to proposition Y	Tend to prefer proposition X to proposition Y	Tend to prefer proposition Y to proposition X	Strongly prefer proposition Y to proposition X	Proposition Y
Corporate governance is a private affair and should be flexible. We have done enough, and if more standards are required, it can be done at the national level. The EU should be aware of mission creep.					The promise of integrated capital markets, and/or of a European civil economy, is huge. It follows that the EU should continue to find ways to improve and harmonise governance.
If legislators must intervene, it should be on a comply-or-explain basis.					Surely we have learned that comply-or-explain doesn't work.

• Individual Observation — Workshop Average

# **ACTION MEMORANDA**

# ACTION MEMORANDA FOR THE EUROPEAN COMMISSION

- Commission could promote investor engagement with companies by, for example, considering a guidance statement for companyboards and institutional investors articulating its stewardship expectations.
- Commission encouraged to promote investors' stewardship by improving upon existing mechanisms.
  - Cross-border voting improvement.
- Commission should encourage monitoring mechanisms in individual member states to give substance to soft law.
  - Assurance that states have such a mechanism.
- Commission may consider how further governance policy work might be integrate within CMU (DG FISMA vs DG JUST).

# ACTION MEMORANDA FOR INSTITUTIONAL INVESTORS

- Critical role to play in making 'Comply or Explain' effective (I.e. Pressing for rights).
- Asset owners & managers have complementary roles.
  - Asset owners should expect/request investor stewardship in investment mandates.
  - Asset managers shoulder the reconciliation of business models, conflict of interests and stewardship capabilities & resources.
- Scope for Commission to be clear about investors' expectations (I.e. Disclosure both to the clients & public).
- Institutional investors should broaden their risk perspective by including long-term and ESG factors (Civil society gap)?



# ACTION MEMORANDA FOR THE EUROPEAN PARLIAMENT

- Parliament pressing for stakeholders right model (Social objectives).
- Parliament should recall that Institutional Investors represent citizens and employees.
- Stakeholders issues converge with investors' interests.
  - Should encourage to integrate ESG factors in the investment process.
- Parliament should encourage dialogue to ensure adequate communication and mutual understanding.

# ACTION MEMORANDA FOR EUROPEAN COMPANIES

- Number of conflicts between controlling shareholders and institutional investors.
  - Good governance aims at reconciling and minimizing those.
- Need for credibility of 'Comply or Explain' approach between companies and investors.
  - Compliance with code or thoughtful justification for deviation.
- Need for constructive attitude from companies towards investors to establish long-term relationships.
  - Understanding of key issues such as:
    - Shareholder rights
    - Board effectiveness
    - Remuneration

# ACTION MEMORANDA FOR CIVIL SOCIETY

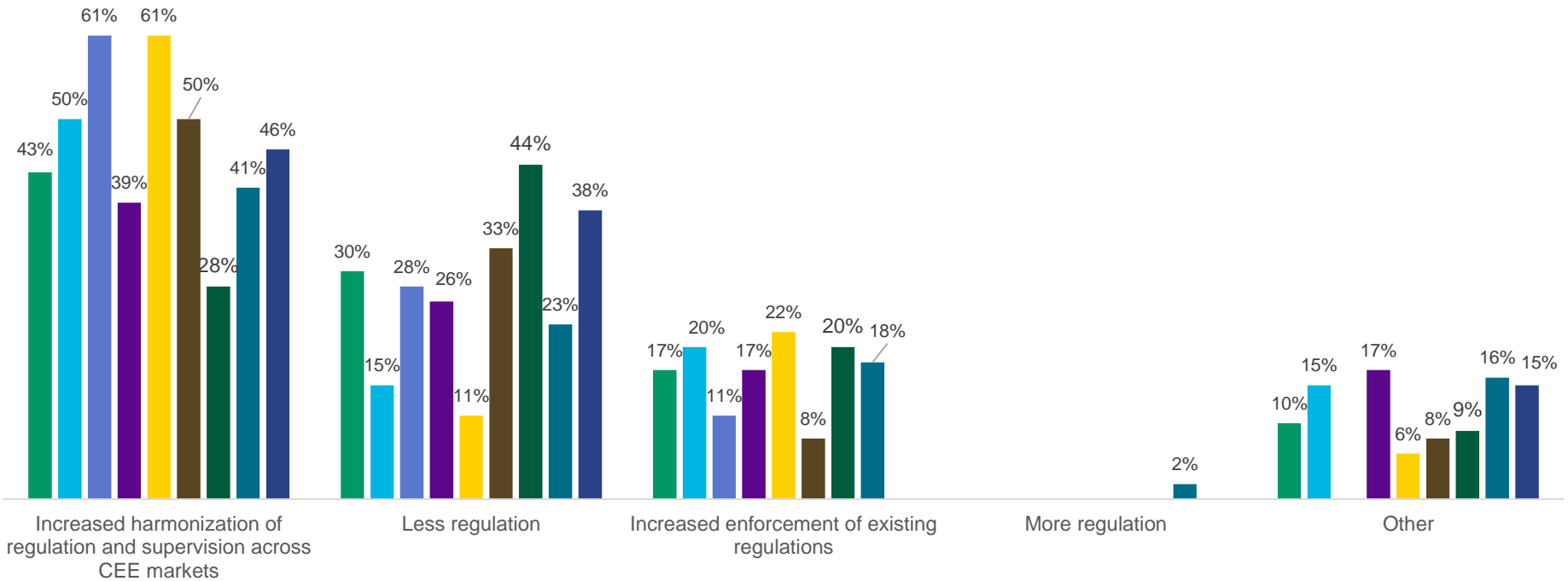
- Civil society groups' expertise is often better to monitor for poor stakeholder practices (Anti-corruption, Human rights, Business ethics).
- Institutional Investors should regard Civil society as a potential partner.
- Civil society groups should often recognize the roles of institutional investors.
  - Financial issues come always first but;
  - There is still room for improvement in the governance of stakeholder & social issues.

# CFA INSTITUTE'S CEE SURVEY 2018

# INCREASING CAPITAL MARKET ACTIVITY

- TOTAL (n=263)
- BULGARIA (n=20)
- CYPRUS (n=18)
- CZECH REPUBLIC (n=23)
- GREECE (n=36)
- HUNGARY (n=24)
- POLAND (n=82)
- ROMANIA (n=44)
- SLOVENIA (n=13)

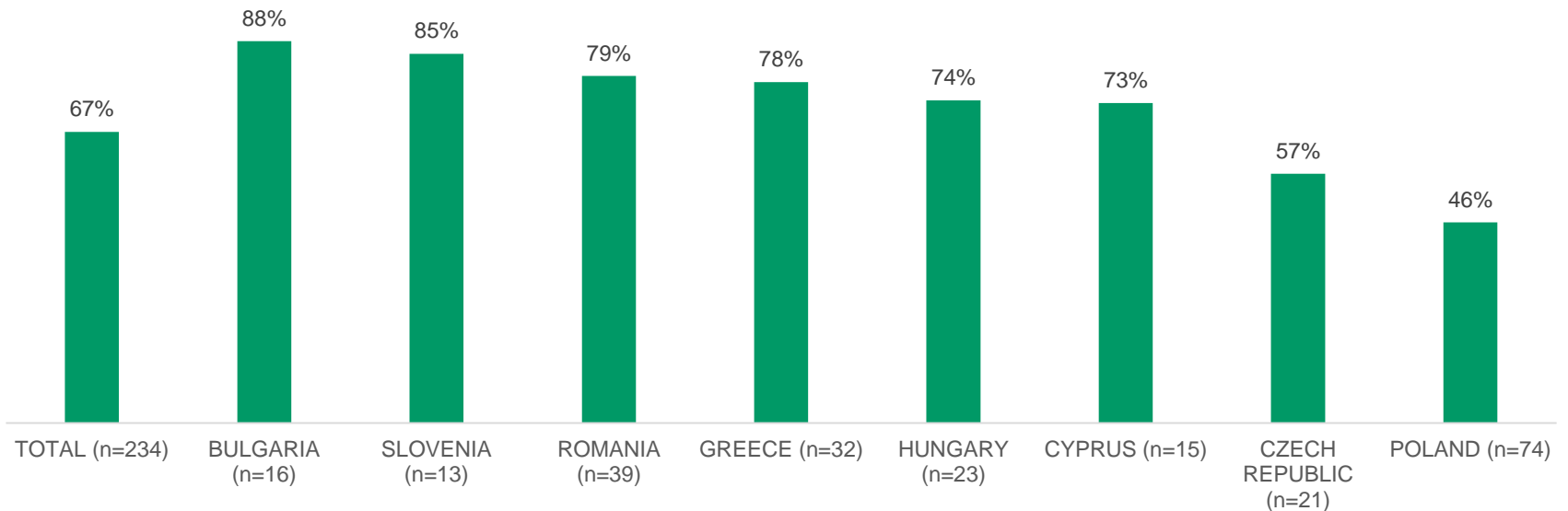
43% of respondents think increased harmonization of regulation and supervision across CEE markets is the best regulatory approach.



Question: What do you think is the best regulatory approach to increase capital market activity in your local market?

# SUPERVISION OF EUROPEAN FINANCIAL MARKETS

67% of respondents agree with greater centralisation of supervision of European financial markets by a common EU regulatory body.



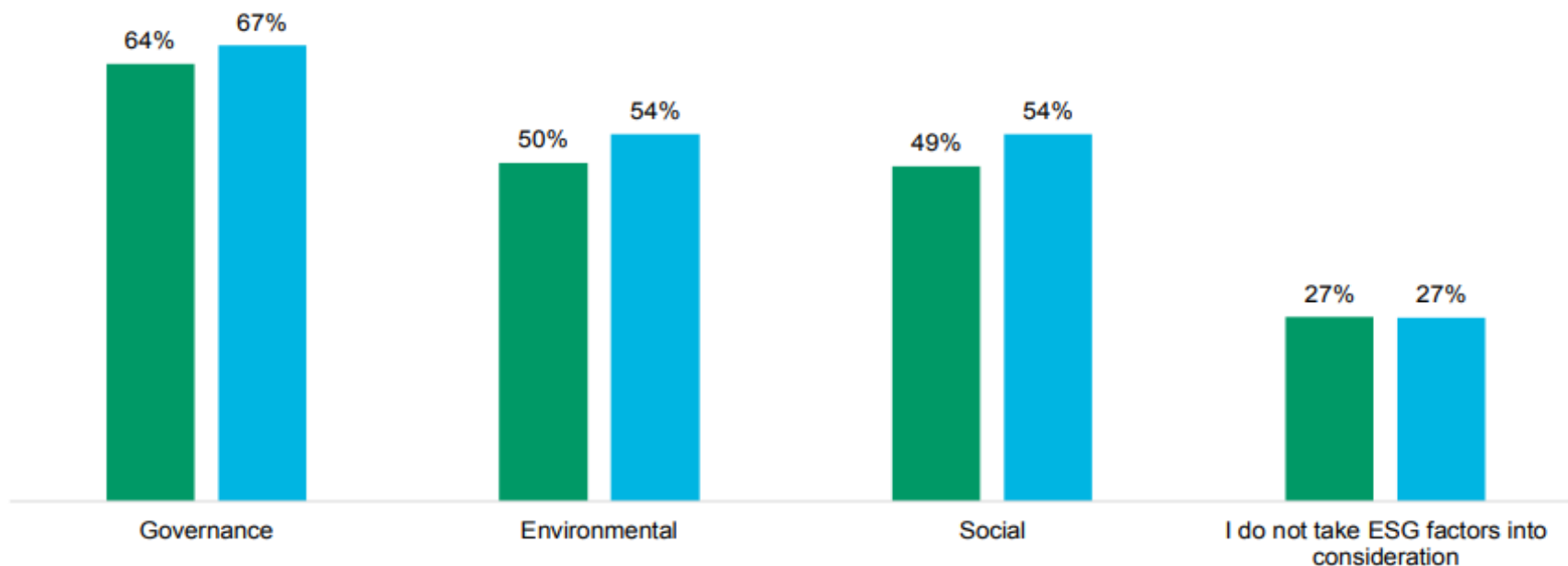
Question: To what extent do you agree with greater centralisation of supervision of European financial markets by a common EU regulatory body (for instance the European Securities and Markets Authority)?  
Scale: Strongly disagree 1 to Strongly Agree (Chart displaying % Agree (4+5))

# CFA INSTITUTE'S ESG SURVEY 2017

**73% OF SURVEY RESPONDENTS TAKE ESG ISSUES INTO ACCOUNT IN THEIR INVESTMENT ANALYSIS AND DECISIONS, WITH GOVERNANCE BEING THE MOST COMMON, THE SAME AS 2015.**

**WHICH, IF ANY, OF THE FOLLOWING ESG (ENVIRONMENTAL, SOCIAL, GOVERNANCE) ISSUES DO YOU TAKE INTO ACCOUNT IN YOUR INVESTMENT ANALYSIS OR DECISIONS?  
SELECT ALL THAT APPLY**

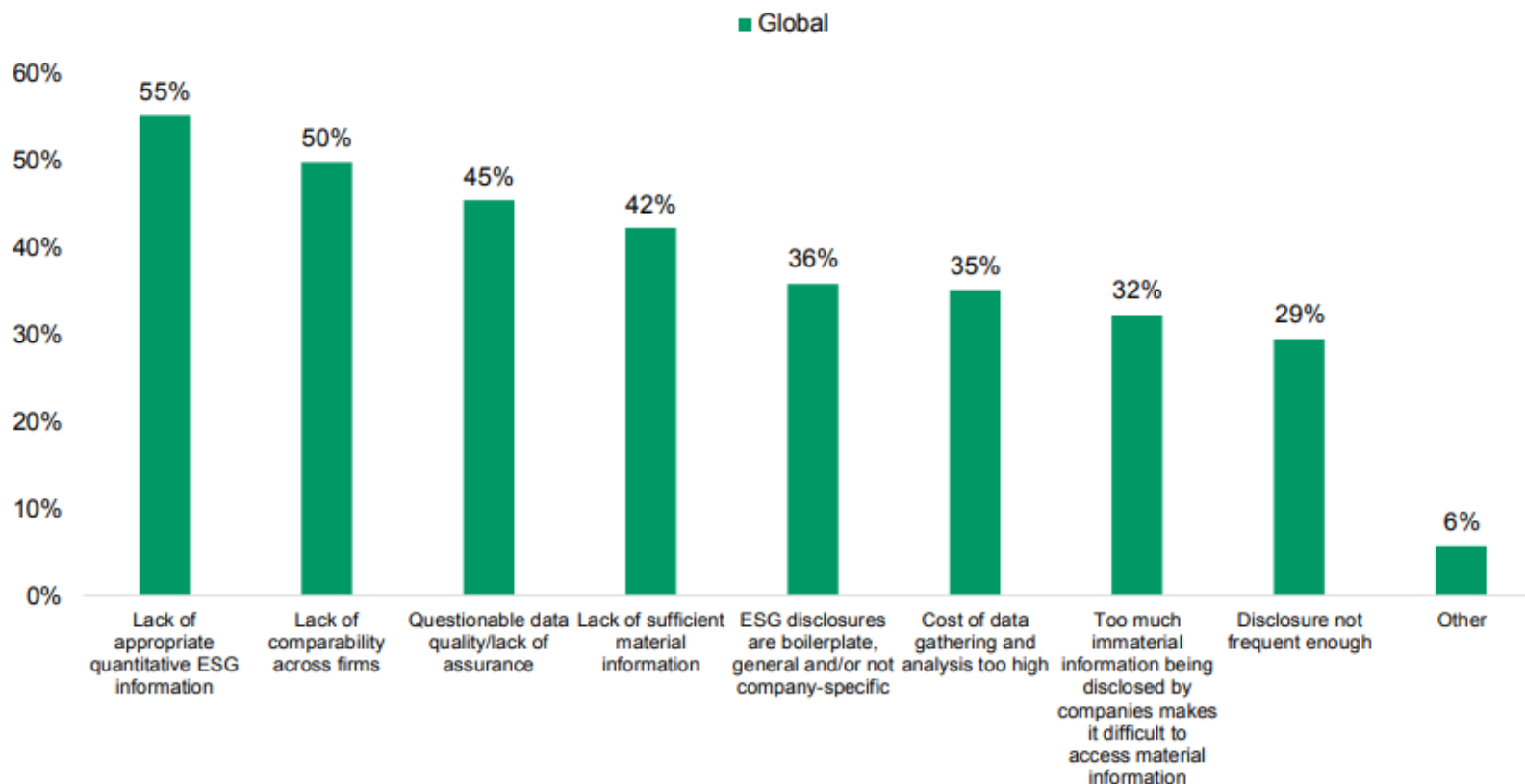
■ 2015 ■ 2017





THE THREE FACTORS THAT MOST LIMIT RESPONDENTS' ORGANIZATION'S ABILITY TO USE NONFINANCIAL INFORMATION IN INVESTMENT DECISIONS ARE A LACK OF APPROPRIATE QUANTITATIVE ESG INFORMATION, A LACK OF COMPARABILITY ACROSS FIRMS, AND QUESTIONABLE DATA QUALITY/LACK OF ASSURANCE.

WHAT FACTORS LIMIT YOUR ORGANIZATION'S ABILITY TO USE NONFINANCIAL INFORMATION IN YOUR INVESTMENT DECISIONS?  
SELECT ALL THAT APPLY.



Only asked of those who take at least one ESG issue into consideration; not asked in 2015

# SUSTAINABLE FINANCE

# EUROPEAN PARLIAMENT REPORT ON DISCLOSURES RELATING TO SUSTAINABLE INVESTMENTS AND RISKS

- Push for integration of ESG risks into investment-decision making;
- Transparency rules related to how financial market participants integrated ESG risks **to be applied to all financial products;**
- Policies on how sustainability risks are incorporated should be set in areas of asset allocation, investment strategy, risk management, governance, and in the **exercise of shareholder voting and company engagement;**
- **Integration of sustainability risks in remuneration policies**

# **HLEG REPORT ON SUSTAINABLE FINANCE 2018**

# GOVERNANCE AND LEADERSHIP

- Corporate culture in the financial sector needs to be better aligned with a long-term outlook;
- The composition of executive and supervisory governing bodies is the key lever for aligning businesses more closely with long-term perspectives;
- The exercise of stewardship responsibilities is a key expression of investor duties to integrate material ESG risks into their investment process;
- For investor stewardship to be effective, it is essential that the consideration of sustainability risks and opportunities becomes an integral part of the way in which the investee companies are governed;
- The removal of technical obstacles in exercising voting rights is essential for effective stewardship.

Source: High Level Group report on sustainable finance, 2018

# HLEG RECOMMENDATIONS

- Supervisory manuals should be updated to include sustainability as a risk against which the skills and competences of the members of companies' governing bodies should be assessed;
- Extending the Stewardship Principles for institutional investors, for example, by amending the Shareholder Rights Directive or a similar instruments;
- Strengthening director duties related to sustainability.

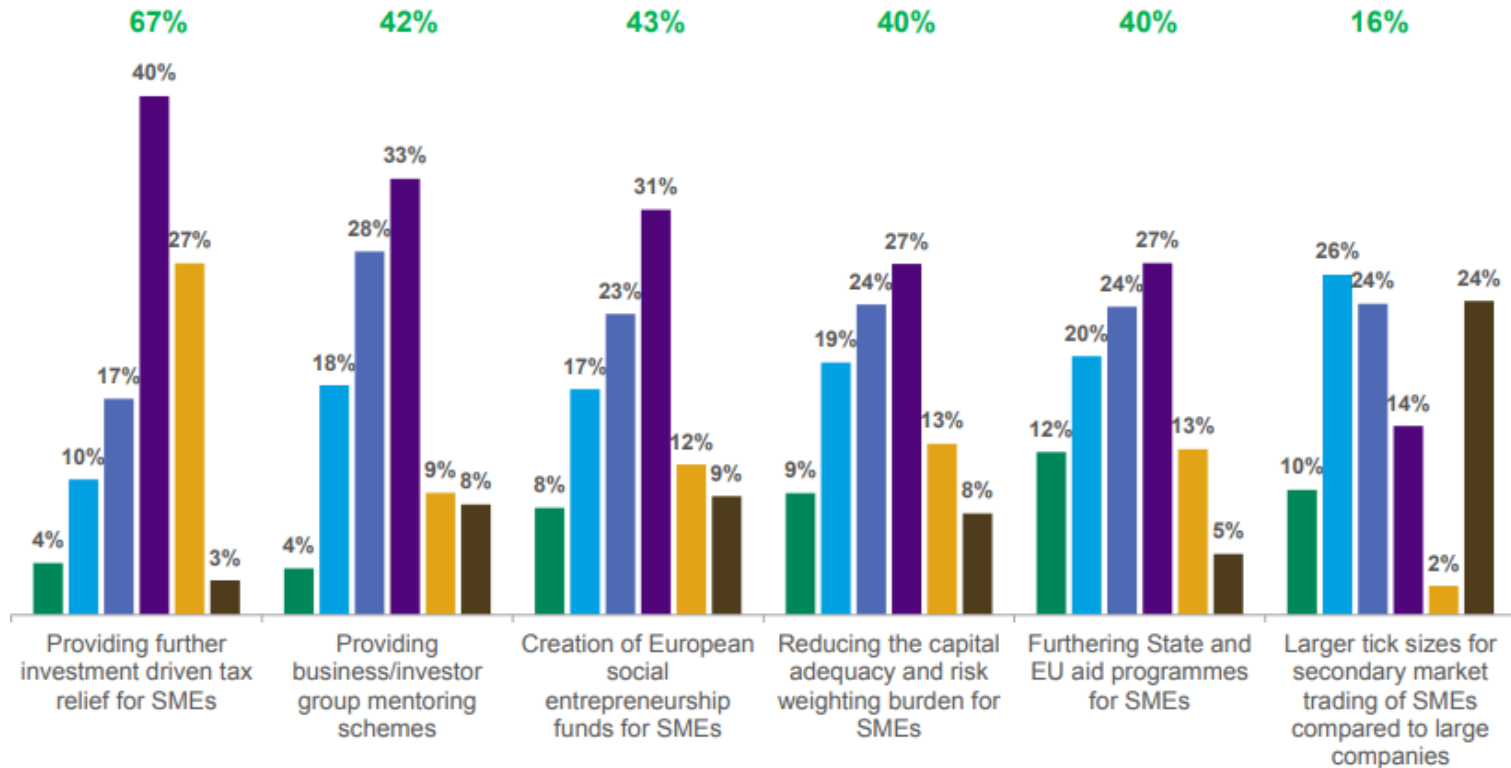
Source: High Level Group report on sustainable finance, 2018

# INVESTORS AND SMEs FUNDING

# SUCCESS OF POTENTIAL SOLUTIONS

How successful, if at all, do you think the following potential solutions would be at attracting investor interest in SMEs?

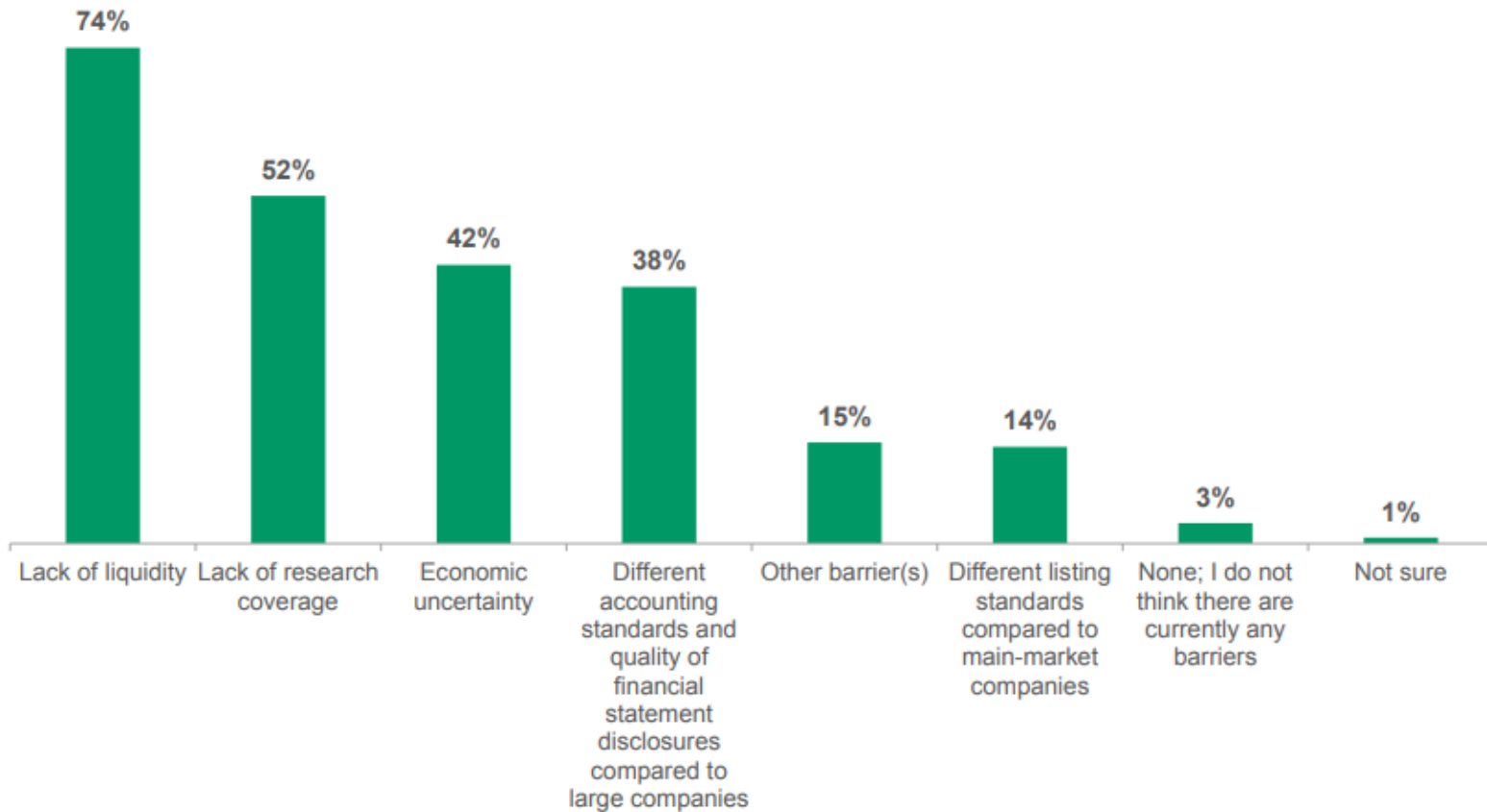
■ Not at all successful 1 ■ 2 ■ 3 ■ 4 ■ Very successful 5 ■ Don't know





# BARRIERS OF SMEs

What barriers, if any, currently exist that impact investor interest in Small and Medium Enterprises (SMEs)?



**BETTER CORPORATE GOVERNANCE CANNOT  
BE ACHIEVED BY REGULATION ALONE!**

# STATEMENT OF INVESTOR RIGHTS

# WHEN ENGAGING THE SERVICES OF FINANCIAL PROFESSIONALS AND ORGANISATIONS, I HAVE THE RIGHT TO

- Independent and objective advice and assistance based on informed analysis, prudent judgement, and diligent effort;
- Disclosure of any existing or potential conflicts of interest in providing products or services to me;
- Clear, accurate, complete and timely communications that use plain language and are presented in a format that conveys the information effectively.

“Our world may have changed, but the importance of integrity has not.”

Frank Sonnenberg



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