



# **ECGS CORPORATE GOVERNANCE PRINCIPLES**

**A Partnership for Local Market Expertise**

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This document is the third edition of the ECGS Corporate Governance Principles. The Principles represent a consensus between ECGS research organisations: Ethos, Proxinvest, DSW and Shareholder Support. ECGS Principles are based on the local European market experience of the ECGS researchers themselves as well as on national and international codes of best practice. These principles underpin the analysis and voting recommendations made to clients of the European Corporate Governance Service and set best practice standards for the largest European companies.

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## **The ECGS approach**

The application of the ECGS principles is tailored to fit with the local market and particular circumstances. As a minimum we believe that companies should strive to comply with local market corporate governance codes. Nevertheless, ECGS considers that companies should go beyond local market codes and work towards national and international best practice in both corporate governance and corporate responsibility. While ECGS principles are written in terms of international best practice, voting advice will be considered in the light of specific circumstances as they relate to a specific company and various contexts during the year reviewed.

We seek to ensure consistency and fairness in determining voting advice. However, guidelines cannot be issued for all eventualities, and in particular situations, the relevant member providing the advice will exercise its own judgement. ECGS reserves the right to amend voting recommendations in the light of developments and particular situations.

In general, voting recommendations are as follows:

**FOR:** The proposal reflects acceptable practice and is not contrary to shareholders' interests;

**OPPOSE:** The proposal is not acceptable in our opinion and is not in shareholders' interests over the long term;

**ABSTAIN** (only applicable in certain markets): The proposal raises issues of concern but not regarded as sufficiently material to warrant opposition.

## Introduction

- Impact Investing

ECGS provided its full support to the UK Stewardship Code for institutional shareholders published in July 2010. ECGS intends to promote the Stewardship Code with international clients in order to ensure their adherence to its principles and encourages the development of a European Stewardship Code.

Shareholders are accountable for how they fulfil their ownership responsibilities. Trading activities driven by short-term considerations can undermine a long-term approach and responsible voting. ECGS considers that institutional investors calling for openness and accountability from companies, should, in turn, be accountable regarding their corporate governance activity. We support the publication by institutional investors of their corporate governance and voting policies and their full voting records.

ECGS encourages its clients in voting in all countries and advocates for appropriate cross border voting procedures.

- The equitable treatment of shareholders

European countries display important differences over share ownership structures depending on the degree of dispersed ownership of public companies and the presence of very large shareholders. Whereas the major issue in companies with a dominant shareholder is minority shareholder protection, in the case of companies with widely dispersed ownership, enforcing all shareholder rights and managerial accountability are predominant. ECGS supports the overriding principle of equitable treatment of all shareholders. ECGS reports will highlight the presence of dominant shareholders in companies and associated corporate governance issues.

All shareholders that hold voting shares, no matter the size of their holding, should be allowed to attend the shareholders' meeting, have the right to ask questions and vote in person or by proxy at the meeting. ECGS reports will highlight any limitations on this point.

- Publication of voting results

Investee companies (or designated regulatory bodies) should publish details of votes cast or proxies received. The published figures should include what proportions of shares and/or voting rights were voted on each resolution and the level of support, abstention (where applicable) and opposition.

# 1. Annual Report/Account vote

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## 1.1 Disclosure of shareholders' meeting notice and reports and accounts

In order for shareholders to hold directors formally accountable they need to have adequate notice of the meeting and the matters to be discussed. The notice of meeting should be sent to shareholders at least 21 days in advance for annual general meetings and for extraordinary meetings when possible.

The company should make available (in electronic form and on request) all relevant documentation shareholders require to make an informed judgement on the resolutions to be decided. The company should preferably issue documents in its local language as well as in English in order to maximise the understanding of the issues by international shareowners.

## 1.2 Compliance with the local market governance code

The company should provide shareholders with a complete compliance statement in relation to all codes applicable to the company's operations.

## 1.3 General transparency & reporting

As well as reporting financial performance, companies should provide additional information on a range of issues in respect of all stakeholders such as:

- Corporate strategy
- Key Performance Indicators (financial and operational)
- Corporate governance system
- Shareownership structure
- Remuneration arrangements
- Auditors related policies
- Employment policies, policies on environmental issues, community relations and business ethics
- Contentious issues that have arisen in the year under review
- Conflicts of interests, related party transactions and self-dealing
- Internal controls

## 1.4 Share structure and voting rights

A company's share structure should be clearly disclosed including the voting rights and other rights attached to each class of shares. Information on the major owners of shares and voting rights should also be provided. Information on any cross-shareholdings or voting agreements should be reported.

ECGS strongly supports the principle of 'one share one vote' for ordinary share capital. We consider that shareholder rights and voting power should be proportional to ownership. Any deviations from the principle of 'one share one vote' will be identified in ECGS reports.

The existence of core shareholders with rights to board representation or other more favourable rights creates conflicts of interests and safeguards need to be in place for minority and non-controlling shareholders. ECGS will review the following principles:

- all connections and relationships past and present between directors and controlling shareholders should be clearly identified;
- the existence and terms of any relationship agreements should be disclosed;
- a majority of the board should not have any connection to the core shareholders;
- the board chairman should not have any connection to the core shareholders;
- all directors, including appointees of core shareholders, should be subject to retirement by rotation;

## 2. Allocation of income/Dividend vote

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ECGS members will assess dividends on a case by case basis, although ECGS considers that shareholders should have an annual opportunity to vote on the directors' dividend policy. In principle, ECGS believes that dividends should be covered by earnings. Where they are not, emphasis will be placed on the board's justification for the proposed dividend and an explanation of the on-going policy.

## 3. Discharge of Boards

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A regular item on meeting agendas in a number of countries is a proposal to grant a discharge to the board for its stewardship of the company. This type of proposal has different meanings in different countries and will therefore be treated in line with the research partner's guidelines based on their knowledge of the local market and the impact of supporting such a resolution.

ECGS will reflect serious concerns over the conduct of a director on the discharge. More generally, ECGS does not encourage the use of the discharge when it is not legally required or when it prevents shareholders to pursue future legal action.

## 4. The Board structure & the election of directors

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The most obvious difference in corporate structure across Europe is between companies with a two-tier board, where the executive and supervisory functions are split, and the unitary board combining individual directors with and without executive functions. Further differences arise in the balance of power, in decision making and accountability. ECGS believes that both systems can be highly effective. Additionally in a number of European countries, employees have legal rights to board representation without these members necessarily being subject to election.

### 4.1 Disclosure

Disclosure about the directors and the board is critical in enabling shareholders to form a proper judgement when electing and re-electing directors. ECGS considers at least the following information should be disclosed:

- Directors' attendance record at board and committee meetings;
- Procedures in place for board and director appraisal and succession planning;
- Biographies for all directors including dates of appointment, ages, career history prior to and at the company, current and recent significant positions in public, commercial and political life; interests in the capital of the company or group, both actual and contingent;
- The terms of each director's contractual terms or letters of appointment;

### 4.2 Board size

The board should not be so large as to be unwieldy. The board should be of sufficient size so that the balance of skills and experience is appropriate for the requirements of the business and that changes to the board's composition can be managed without undue disruption.

### 4.3 The role of board committees

ECGS considers all companies should establish standing audit, remuneration and nomination committees or equivalents. The terms of reference for each committee should be made publicly available to shareholders.

Committee membership, frequency of meetings and attendance records (including other invited parties), should be disclosed in annual reports.

### 4.4 Number of positions

According to ECGS, shareholders should be assured that directors have sufficient time to devote to the company in case of exceptional circumstances and to attend short-notice meetings. To do this, full disclosure of other positions should be provided in the annual report, together with the record of each director's attendance at board and committee meetings.

Some European corporate governance codes set limits on the number of external positions that may be held by directors. ECGS will take into account aggregate time commitments and effective attendance to board and committee meetings while making a voting recommendation.

#### **4.5 Boardroom diversity**

ECGS encourages boards to recruit new directors from the widest possible pool of potential candidates. ECGS will review the transparency over nomination and appointment processes.

#### **4.6 Election & re-election**

The composition and effectiveness of the board is a crucial element in determining corporate performance. ECGS believes it is fundamental that all directors are required to seek regular and individual re-election. ECGS will accept a term of up to four years in most countries and will reject slate voting except in countries where it is legally required.

Voting advice of ECGS reports takes into account the overall structure of the board in terms of its composition, separation of powers, the relationship between executive and independent directors and board committees. They also focus on aspects of directors' appointments which can be clearly assessed: the process by which individuals are appointed, their contractual terms, their independence (in the case of non-executives), and the provision of sufficient information to allow a clear judgement on their calibre, experience and potential conflicts of interest.

## **5. Election of the chairman**

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Given the serious questions of concentration of power raised by combining the roles of chairman and chief executive, a decision to combine the roles should be publicly justified. Where the positions are held by the same individual it is more important that there is a strong and independent element on the board, that there are robust procedures to ensure that the board functions effectively, and that relevant issues are discussed. As a matter of principle, ECGS believes that the chairman should not carry executive responsibilities. ECGS also questions the practice where the chief executive becomes the chairman of the board or supervisory board. While this may provide continuity, it risks causing difficulties in respect of the board's supervisory function and may inhibit an objective assessment of management and strategy and of the initiatives of the successor CEO.

## 6. Election of executive directors (not applicable to two-tier board structure)

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The number of executives should be in line with local market practice. ECGS will also take into account the general level of independence on the Board and termination benefits while voting on executive directors.

## 7. Election of independent non-executive directors

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Independent directors have a crucial role to play in reviewing the performance of the executive membership. They also bring an external perspective to bear on issues where the executive directors face an actual or potential conflict of interest such as remuneration, proposed changes in control or acquisitions, and the audit function. They should also strengthen the board by expanding its range of experience. Such directors need to be remunerated adequately to reflect their responsibilities but the risk of independence being impaired by reliance on fees or other remuneration needs to be borne in mind.

### **Factors taken into account by ECGS members which may compromise independence include:**

- A former executive position within the company or group (including major acquisitions) or a contract of employment since less than 5 years;
- An association with the business of 12 years (9 years in the UK and Ireland);
- Relationship through blood, marriage or equivalent to other directors, managers, important shareholders or advisers to the company;
- Appointment other than through an appropriately constituted nomination committee or equivalent independent process;
- A material connection with a professional adviser including auditors to the company since less than three years;
- A side-contract including fees, share options or other conditional remuneration, consultancy payments, pension benefits or benefits from related party transactions above a material threshold;
- Receipt of similar remuneration from a third party in relation to the directorship;

- Cross directorships or significant links with other directors through involvement in other companies or bodies;
- A current or recent senior position with a political or charitable body to which the company makes or from which the company receives material contributions
- A significant (3%) holding in the company's equity
- Current or recent involvement at a senior level in another entity with a material financial or commercial interest in the company either through a shareholding or family link, or as customer, supplier, banker, joint venture partner or competitor;
- An appointee or representative of a group other than the shareholders as whole.

## 8. Remuneration reports

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While analysing the remuneration, ECGS takes into account several factors specific to local market practice. ECGS members will use their local market knowledge when assessing these questions.

In determining the voting outcome, ECGS will consider the adequacy of disclosure and the structure of the remuneration system, including but not limited to:

- overall policy including target pay levels whereby the company acknowledges local market sensitivities regarding pay levels and increases;
- whether overall pay philosophy and structure is linked to sustainable long-term value creation for all stakeholders and shareholders;
- a clear description of key remuneration components and their proportion
- a pay-for-performance principle including a claw back clause and an annual assessment

ECGS might reflect concerns over the remuneration system on other resolutions if the opportunity to vote on the remuneration is not provided to shareholders.

### 8.1 Disclosure

ECGS might recommend an oppose vote if the company fails to disclose its remuneration policy in a timely manner or if information provided to shareholders is insufficient to assess the structure and components of the remuneration.

### 8.2 Overall policy

Executive remuneration packages should fairly reward good corporate performance with high remuneration geared to the achievement of targets that are stretching but do not encourage imprudent risk-taking, excessive conservatism or continuation of strategies that are no longer appropriate. The remuneration structure should balance the legitimate interests of the director with the potential cost to shareholders.

Aspects to be considered will include:

- The level of base salary compared with market and sector practice
- The on-target annual bonus paid compared to fixed remuneration and the cap

- The on-target long term incentives compared to fixed remuneration and the cap
- The link between long-term performance and strategy

Policy statements should include a description and explanation for all elements of pay, justification for the choice of performance criteria and the level of targets, a description of how the remuneration strategy fits with overall corporate strategy and key performance indicators. The company should also refer to the relationship between directors' remuneration and employee remuneration levels. Factors specific to the company should be emphasised rather than relying on a general market rationale.

### **8.3 The roles of remuneration committees and shareholders**

Remuneration committees should not have the discretion to amend share scheme performance targets, criteria or performance periods without explicit shareholder authorisation. When considering pay policy, remuneration committees should have access to independent advisers, separate to those used by the executives and these advisers should be disclosed.

### **8.4 Contractual terms**

As a best practice rule, executive contracts should not include severance payments. Nevertheless, termination payments not exceeding one year of basic salary and time and performance pro-rated bonus is acceptable. Any potential payment in excess of one year of salary and pro-rated bonus may become an issue for ECGS. It will be analysed according to local practice, local corporate governance code and specific rules country by country.

### **8.5 Pensions and other post retirement payments**

Companies should disclose the yearly pension cost or pension contributions. As a deferred remuneration not linked to performance, pensions should be limited in regards to total remuneration. In defined-benefit plans, the acquisition of pension rights should be granted proportionally over time (subject to seniority). The pension arrangements for each executive should be disclosed properly and should be in line with market practices.

## **9. Executive incentive schemes**

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Employment markets (affecting recruitment, retention and motivation) and legislation, taxation rules, over all mix of packages (basic salary, incentive awards and benefits) and overall complexity differ significantly across Europe. These differences will be taken into account when assessing whether to recommend approval of a proposed scheme. Each ECGS report will examine the following areas:

- Performance conditions;
- A vesting scale linking higher rewards to the achievement of exceptional rather than average performance;
- An expected value calculation for share based awards;

- The maximum level of potential awards;
- Evidence that the scheme itself and the overall package is not excessive;
- Potential dilution level

In the various markets there are different requirements with regard to shareholder authorisation of executive incentive schemes. If shareholders do not have the opportunity to vote separately on executive share schemes, ECGS will apply its incentive scheme voting policy on the remuneration report or upon the share issue/repurchase authorities used to fund these schemes.

## 10. Employee incentive schemes

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Incentive schemes for employees vary considerably across markets. Frequently they are the result of country specific legislation and tax regulations. In principle, ECGS is supportive of schemes which enable all employees to share in business success unless the dilutive effects of the plan are too disadvantageous to the shareholders.

## 11. Director fees

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The statement of policy should also deal with non-executive directors' remuneration. Performance related remuneration, such as bonuses or share options are considered inappropriate for independent directors as they may inhibit objective reviews of strategy.

## 12. Auditor election

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### 12.1 Audit committees

We consider that an audit committee consisting solely of independent directors is best practice. To assist shareholders in understanding the operation of the committee we believe that it should have written terms of reference and that these should be made publicly available. Audit committees should also produce a report of their activities to shareholders as part of the company's corporate governance disclosures. These should include information on the number of meetings, attendance rates, the issues discussed and whether management representatives were present.

### 12.2 Auditor independence

The independence, objectivity and effectiveness of the external auditor are of vital importance to shareholders, both in respect of individual companies and in terms of their public policy function of

ensuring confidence in financial reporting. When voting on the auditors' re-election, ECGS will take into account:

- the proportion of fees paid for non-audit work against audit work during the year;
- the proportion over a three year period;
- the type of fees paid;
- links to the board or senior manager;
- the auditors' terms and the change in lead audit partner.

### **12.3 Non-audit work**

We do not believe that audit firms should be employed to provide consultancy services to the management and also to undertake an independent audit on behalf of the shareholders at the same company or group. We consider that other commercial interests will create a real or apparent conflict of interest and compromise auditors in their ability to confront directors on difficult issues.. Shareholders should be furnished with sufficient information on the nature of the other services provided to be able to make an informed judgement on the work undertaken and the potential to impair independence, in fact or perception.

## **13. Share issues and purchases**

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### **13.1 Share issue authorities with and without pre-emption rights**

A general authority with pre-emption rights (with no specific purpose) should state a clear dilution limit with respect to the issued share capital and should be limited in time. If pre-emption rights are dis-applied, ECGS will oppose a general authority if it is not subject to stricter time and dilution limits.

ECGS applies different thresholds depending on the country when recommending a vote on such resolutions.

### **13.2 Share repurchases**

Shares held in treasury may act as a poison pill, increasing the cost of a change in control. ECGS reports will take into account local market practice. Whatever the purpose of the authority to make market purchases, directors should provide a full justification as to why this is the best use of company resources rather than investment, acquisition, or alternative means of returning value to shareholders. Voting rights attached to shares held by the company or a management-controlled trust should not be used at the management's discretion.

ECGS will take into account:

- the overall limitation of the authority and timeframe;
- the maximum share purchase price compared with the market price on the purchase date;
- whether share repurchase is allowed in defence in time of public tender offer.

## 14. Article changes

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As the articles of association form the basis for the exercise of shareholder rights and protection of their interests, changes rightly require shareholder approval. ECGS reports will consider proposed amendments with particular care to ensure that changes do not negatively affect the position of shareholders. Where a number of changes are proposed in a single resolution, voting advice will reflect judgment on the balance of the changes. It is the view of ECGS that companies should make available in full the existing version. We consider it best practice to put separate resolutions relating to amendments of the articles of association according to the type of amendment requested rather than bundling all changes in one resolution.

## 15. Mergers and Acquisitions

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ECGS will analyse mergers and acquisitions proposals on their individual merits including:

- long term strategic interests of the operation in line with the company objectives;
- the financial terms: valuation of the asset acquired in relation to normal market price as well as the pricing of the new shares in relation to the current stock price;
- the possible impact on shareholders' rights or corporate governance.

Given the importance of issues which are proposed at many EGMs such as major take overs, mergers and rights issues, the notice period for EGMs should be as long as possible and preferably 21 working days. Full information and justification needs to be provided together with an assessment of the likely financial and strategic impact on the company and its stakeholders.

## 16. Anti-takeover defences

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ECGS is opposed to anti-takeover devices employed by companies, which may lead to entrenched management and therefore harm shareholders' interests. Examples of unacceptable protective devices include special board appointment rights, 'poison pills' and voting caps.

# 17. Corporate Social Responsibility

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ECGS will review the most material issues for all stakeholders in terms of environmental and social impacts. Depending on the company's sector and the country market practice in terms of reporting, the following areas will be highlighted:

- Standards against which CSR reporting has been prepared
- Environment
- Employees
- Community
- Business Ethics

ECGS will take into account policies, quantified data and objectives as well as on-going trials or investigations.

## 18. Miscellaneous

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### 18.1 Political donations

ECGS does not generally favour the use of shareholder funds to support political organisations. ECGS will consider the authority limit as well as the use of donations during the year under review when assessing related resolutions.

### 18.2 Shareholder resolutions and counter motions

Shareholder resolutions are an integral part of the corporate governance process. They enable shareholders to take the initiative on issues which directors may be unwilling to address or where directors may face a conflict of interest.

In assessing voting advice on a resolution proposed by a shareholder, ECGS reports will consider:

- Is the matter appropriate for the General Meeting?
- Is it adequately justified by its proponents?
- Is the proposal in the long-term interests of the company and of all stakeholders?

A summary of relevant counter motions will be included in the report.

### 18.3 Extraordinary General Meetings

ECGS will issue voting recommendations when an EGM is convened on a case by case basis, considering:

- Background information
- Financial information
- Strategic analysis
- Shareholding structure & corporate governance impact

A stylized globe with a grid of latitude and longitude lines, rendered in a light blue color. The globe is positioned behind the text, with the word 'European' overlapping it.

European

CORPORATE  
GOVERNANCE  
SERVICE