



A united Europe?

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Readers will not have failed to notice that there has been a major Anglo-French clash in recent weeks about the appointment of the new Commissioner for Internal Markets, Michel Barnier.

The discussion has essentially been about different forms of capitalism. This is not an issue which is restricted to the governments of the UK and France, though. The first decade of the twenty-first century has been turbulent for all involved with corporate governance. It started with the dotcom crash and major corporate scandals, and ended with the worst slump in the global economy since the 1930s.

It is interesting to observe how lawmakers and regulatory bodies have responded to these crises. It is well known that there are major differences in regulatory approach across the world, and probably the most famous distinction is between the adoption of the rigid Sarbanes-Oxley law in the US, and the growth of the 'comply or explain' regime in Europe.

Indeed, the introduction of corporate governance codes in the European Union has been analysed in a recent survey carried out for the European Commission by RiskMetrics Group. Riskmetrics notes that it was the publication of the Cadbury report in 1992 which resulted in the first comply or explain code to be introduced in an EU country. Sixteen years later, all but two member states have a comply or explain-based code.

The RiskMetrics report also identifies two areas for improvement for the comply or explain approach: the quality and information that companies provide on deviations from best practice, and the level of shareholder monitoring. It reckons the first issue could be remedied by strengthening the role of market-wide monitors and statutory auditors, as well as by creating a reporting framework that would ensure comprehensive and qualitative disclosure by companies.

The level of shareholder monitoring, however, is a more complex issue. One telling – and worrying – result from the study was the revelation that the response rate from institutional investors to the questions posed by RiskMetrics and the European Union in the survey was extremely low. Indeed, only 100 of 2,000 investors responded: that's a response rate of just 5 per cent.

The question these results pose is 'how do you make investors more responsible?' True, some investors are very engaged – but there is an element

here of the classic free-rider problem. Much of the market is benefiting from the responsible actions of a few investors. One interesting initiative is now coming from the Institutional Shareholder Committee (ISC) in the UK. The ISC has presented the first code on the responsibilities of institutional investors, defining best practice for those that choose to engage with the companies in which they invest.

It is an interesting document, and one which is very much inspired by the ICGN's 2007 Statement of Principles on Institutional Shareholder Responsibilities. The code is presented under a

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comply or explain regime, and the principles cover: the policy under which the investor will discharge their stewardship; how to handle conflicts of interest; how the investor monitors their investee companies; and how the investor should escalate their activities as a method of protecting and enhancing shareholder value. The code also covers collective action from institutional investors, voting policy and reporting activities. Its weakness, however, is that investors can choose to ignore the code if corporate governance activities are already a part of the investment process.

Even so, the code has been well received, and is already being surveyed by the UK's governance watchdog as a basis for the Investor Stewardship Code that was suggested by the Walker Review of banking governance. It is garnering international support, too: Californian pension fund CalStrs has endorsed the code.

This is all good news for the market – not least because it is an initiative developed by market participants. Hopefully, we will see the development of similar codes in other EU countries, as we have seen with the corporate governance codes – and perhaps even pan-European guidelines on investor responsibilities. That would almost certainly be a project that even the UK and French governments could agree upon.

ABOUT THE AUTHOR

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