NBIM
Norges Bank Investment Management

European Commission
Directorate General Internal Market and Services /
Company Law, Corporate Governance
and Financial Crime Unit,
SPA2 03/103,
1049 Brussels,
Belgium

Date: 19.07.2011
Your ref.: COM(2011)164

Dear Commissioner,

Submission to the Green Paper on the EU corporate governance framework

We appreciate the European Commission's initiative to reform the EU framework for corporate governance. The Green Paper summarizes many of the essential challenges faced by companies, investors and regulatory bodies. In support of our formal submission to the consultation, attached, we make the following summarized comments.

Encouraging shareholder engagement

NBIM recognizes shareholders must be the primary body for corporate governance oversight of the board. We accept the obligation such oversight brings but must always find a workable solution to managing a globally diversified portfolio with many thousand equity holdings. We can be supported in this task by effective, yet proportionate, regulation to secure and exercise our shareholder rights. Clarity, harmonization, transparency, enforcement and sanction are central to effective regulation of corporate governance.

We believe the foundation for effective, constructive engagement is clarity of board communication on corporate strategy and its inherent risks. Only if a board has ensured that all material company risks and external risks are clearly communicated can shareholders carry out the necessary long term, risk based assessment of the company.

Composition and effectiveness of the board of directors

NBIM is convinced that investors and companies must look beyond technical measures of structure and prescriptive composition quotas to determine board effectiveness. We welcome any regulatory path to greater transparency of the qualifications and competencies of non-executive board directors.

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Through our public expectations on board responsibilities we are committed to analyzing the cultural and behavioral aspects of boards and will incorporate this into our dialogues with companies. How the board is ultimately composed should be a decision for the company, its directors and its shareholders.

While respecting the historical origin of national governance standards, the EU can facilitate harmonized definitions and standards across markets. As an example, the EU could establish a clear working definition of an independent director to be used in all EU markets. The absence of such a rule today makes cross border company analysis unnecessarily difficult and time consuming. We have concluded that a harmonized EU definition is the only means to remedy this market problem. The introduction of such a rule would facilitate analysis of board candidates when seeking election and improve the quality of shareholder engagement.

Improving the effectiveness of 'comply or explain'

Comply or explain regimes were born out of a fundamental right, and need, for individual companies to establish, in agreement with shareholders, a framework of corporate governance most suited to their particular requirements. NBIM supports the principle of comply or explain but we have concluded that such a framework will continue to have limited success without more robust mechanisms of monitoring, enforcement and sanction. We therefore also question the rationale of setting up a "comply or explain" regime for shareholders until an effective means of monitoring is first established.

We believe there is a regulatory dimension to facilitate improved comply or explain regimes. Specifically, we seek greater harmonization of definitions and standards across EU authorized markets. Further, we will support any EC initiative to find alternative and additional methods for independent monitoring of company comply or explain statements.

NBIM is unambiguously in favor of high quality regulation when it is recognized to be the best solution to an identified market failure. Any regulation must be accompanied by appropriate enforcement and sanction mechanisms. We hope the process initiated by the Green Paper will lead to an improved framework for corporate governance, improved accountability by asset managers and asset owners, and a well-functioning investment environment.

Yours sincerely,

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Global Head of Ownership Policy

Jan Thomsen
Chief Risk Officer

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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?*

No. NBIM does not favour differentiation based on company size. Every listed company has made a conscious choice to seek the economic benefits of external capital. By doing so, the board has accepted the obligations of public market participation. Rather than differentiation on grounds of size, we should seek simplification and harmonization of corporate governance standards across markets.

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?*

NBIM does not offer an opinion on corporate governance requirements for unlisted companies as our investment mandate is predominately in the sphere of listed equity. That being said, we believe listing a company's equity on a public market comes with a new set of obligations that cannot be born on the first day of listing. Corporate governance structures and policies set up on or immediately before listing are unlikely to be solidly anchored in the corporate culture. We suggest companies seeking listing should present a report in the listing particulars that sets out the history of governance planning. This could be done as part of the listing requirements.

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?*

Yes. NBIM advocates the separation of chief executive officer and chairperson. As the board has, primarily, a supervisory responsibility, the role of the chairperson needs to be wholly unhindered and therefore separated from the role of a manager. The supervisory function of the board is a critical aspect of good corporate governance. In those regulated markets where combined chief executive officer and chairperson is still possible, we recommend that the EU provides a definition of the role of chairperson. This will set the stage for a clear differentiation of role from that of chief executive officer.

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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?*

The interest of good corporate governance will be well served if greater attention is placed on the capabilities and competences of individual directors and the aggregate balance of these skills on the board. In the annual report, companies should disclose their board recruitment policy and set out a matrix of the skills of the current board of directors and compare this with the set of skills and diversity targeted in the nomination process. In this evaluation the company should be unencumbered by regulation to determine the most appropriate board. Only regulation to ensure harmonized disclosure should be necessary. Such disclosure will materially improve transparency and should be mandated by the EU.

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. Such regulatory disclosure will support and aid investors' understanding of company governance practices, preferences and culture.

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

NBIM argues that the main objective is to compose a well-functioning and effective board with the appropriate balance of skills, competence and experience. If we do not find evidence of a diverse board then we will assume the recruitment process may be sub optimal. Diversity of gender should be evaluated on the same basis as independence, skills, age, experience or nationality. We should seek other means to achieve our goal of board effectiveness, but if the most efficient means to improve board effectiveness and recruitment processes is setting diversity quotas, we will be supportive.

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?*

Yes. To enhance the quality of boards, more capable and dedicated board members are required. Limiting the number of board positions will open the opportunity for greater

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diversity of boards and more competition among board candidates. The objective of a board member should be to act in the best interest of the company and thereby protect the long term interests of shareholders. Directors holding numerous positions run a risk of over committing themselves at times of unexpected corporate activity. These are the very times when shareholders rely on the focused attention of directors. In its recruitment process, a board must analyse board members' time spent on other board positions and the consequence for the company of such external allocations of time. We make no formal recommendation on a board membership ceiling for non executive directors. We do, however, recommend that Chairmanship should be limited to one listed company. In the case of executive directors taking on external non executive positions, we seek that the right to take on such directorships are part of the executive's employment contract.

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

Our analysis suggests the success of a board evaluation process cannot be determined on the basis of whether it is carried out internally or externally. We have witnessed effective internal and equally effective external evaluation processes. The challenge for company boards is to establish a process with sufficient transparency that is effective in outcome. We advocate that boards of listed companies should be required to regularly conduct an evaluation, both in order to improve the works of the board and to evaluate the current and required competencies of the board.

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. The EU should establish a standardized format and set requirements for executive remuneration disclosure. Remuneration reports should be concise and principle based. The trend towards lengthy, opaque and largely incomparable remuneration reports is not a viable reporting model and one NBIM rejects.

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

Voting on remuneration reports is a time and resource consuming distraction. We are wholly unconvinced by the prominence awarded to this aspect of governance policy making. Furthermore, we have yet to find evidence that a shareholder vote has proved an

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effective lever to raise board accountability or stem the asymmetry between pay and performance. If our appeal for a market-wide rethink on the approach investors are taking to remuneration is premature then, at the very least, if a vote is mandatory then the outcome should be binding.

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?*

Proper risk management is the critical task and responsibility of the board. The board must show awareness of the risks and bear the responsibility for setting out a strategy to manage, not minimize, the risks and linked rewards in the best possible manner. The board should report on risk in a consistent, timely and comprehensive manner such that shareholders can make a considered investment decisions. These responsibilities for managing and reporting on risk should also apply to relevant key societal risks.

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. It is the responsibility of the board to ensure that companies address material risk as an integral part of business strategy and effectively allocate resources to manage these risks. We make particular reference to any relevant social or environmental risk that should be included in these considerations. A common reporting framework for such risks taking industry idiosyncrasies into account would be welcomed.

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 investment horizon of any asset manager should be guided by the contract with the asset owner and not through regulation. The frequency of financial reporting should be reviewed, it being suggested that material information should be disclosed immediately rather than through the pre-electronic era arrangement of quarterly reports.

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?*

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Regulation of incentive structures and performance evaluation for asset managers are not desired. NBIM would encourage measurement and remuneration of absolute performance in addition to relative performance, but asset owners will, in signing an asset management contract, provide for incentives aligned with their investment objectives.

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?*

We believe it would be inappropriate for NBIM as asset manager to make formal recommendations on monitoring effectiveness by asset owners. But as part of the attribution of an asset management mandate, an asset owner should have the opportunity to require, by contract, any monitoring standards deemed necessary.

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?*

We believe it would not be appropriate for NBIM as asset manager to make formal recommendation on the need for independent governance bodies of asset owners.

17. *What would be the best way for the EU to facilitate shareholder cooperation?*

The EU should establish a clear distinction between shareholder engagement and pooling of control. We support the EU shareholder rights directive (2007/36/EC) and encourage its implementation in all markets. Further, we favour further clarity on the circumstances by which concert party conditions are triggered.

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?*

The proxy voting system needs reform and we are encouraged that the Green Paper on the EU corporate governance framework addresses the issue. Detailed information about proxy agents' activities, income distribution between company advice and voting analysis, conflicts of interests and handling of such conflicts should be fully disclosed by proxy

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advisors. The chain from the asset manager sending a voting instruction to the receiving company is inefficient, has too many intermediaries, and gives opportunity to misuse confidential information. Transmission of voting instruction should no less reliable or secure than distribution of dividends. The EU should require companies to publish voting results within a reasonable number of days and confirm to investors that their votes have been received and accounted for. We also emphasise the need for a harmonized and facilitated system for cross-border voting that can increase shareholder participation in voting.

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?*

Investors are aided in their proxy voting activity by proxy advisors. There is a broad – and competitive – market for proxy advice. Too rigorous regulation of their activities is likely to undermine competition and raise barriers to entry. Our experience suggests that those investors that use the services of proxy advisors do so intelligently. Investors typically use proxy research to enhance their own analysis or overlay onto internal voting principles. The EU should broaden the definition of proxy advisors to include engagement advisors attached to investment managers and proxy solicitation service providers. NBIM is in favour of proxy advisors providing full disclosure of any possible conflicts of interest in providing such services to their investor clients. We also seek improved disclosure of engagement negotiations between advisors and corporate that results in a change of recommendation. For those providers where we have contractual arrangements, NBIM can make these requests directly and make it integral to our procurement process. If self regulation and competitive forces prove insufficient to strengthen the proxy process then formal regulatory processes may be warranted.

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).*

Yes. A common legal framework for better identification of shareholders is appropriate. The legal threshold for disclosure of shareholdings is a good starting point. The EU should establish a common definition of shareholding (direct and indirect holdings including all kinds of derivatives), and create a system for enforcement and sanctioning.

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

We recognise that minority shareholder protection is complicated and difficult in European markets where the controlling shareholder governance model is commonplace. Within a block holder or controlling shareholder regime it must still be possible to ensure all shareholders are treated fairly and equally. Without such expectation of equal treatment, the effectiveness and attractiveness of European markets will be diminished. NBIM expects that shareholders should have the unhindered right to approve key corporate decisions, including the right to elect and remove board directors. We do not believe minority shareholders should have particular engagement rights in companies with controlling shareholders, but there must be improved rights of shareholders to ensure minority shareholders can effectively hold boards to account.

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

Additional remedies are required to protect minority shareholders against improper or unjustifiable related party transactions. Existing rules and self regulated best practices have resulted in asymmetric reporting regimes across EU markets. NBIM expects a board to avoid any conflict of interest and thereby seek, where possible, to decline all related party transactions unless the transaction can be demonstrably accretive for all shareholders. We also expect the disclosed threshold for related party transaction reporting to be a modest monetary value rather than a percentage of a profit and loss or balance sheet item as is typically the case currently. We accept that such a change of reporting threshold will often significantly increase the volume of transactions requiring sign-off by the external auditor, approval by the audit committee and formal disclosure in company reports. This is a necessary consequence of previously weak disclosure requirements.

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

NBIM is in favour of employee share ownership that encourages greater sense of loyalty and responsibility to the company, but believes this is best undertaken at a company level.

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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?*

Yes. If the comply or explain regime of corporate governance is to thrive then the quality of explanation for departure must improve. There must also be improved harmonization and monitoring of companies' statements of compliance. Our analysis suggests that companies can retreat to standard, repetitive, non specific, explanations without adequate sanction. Explanations should be complemented with a requirement to prove any deviation is accretive to all shareholders. Such a requirement to prove the benefits of any deviation would challenge the board of directors and provide for more reflection and better explanation. It should also be considered whether shareholders should be able to vote on any deviation at a regular basis.

We believe the EU can significantly advance the quality of corporate governance across authorised markets by establishing better regulation of comply or explain regimes. NBIM recognizes shareholders must be the primary body for corporate governance oversight of comply or explain regimes. But, we must always find a workable solution to the challenge of managing a globally diversified portfolio with many thousand equity holdings. Consequently, we will support any initiative to find alternative and additional methods for independent monitoring of company comply or explain statements.

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?*

Monitoring bodies should, as a minimum, assess the corporate governance statements and give an opinion as to the appropriateness of the justification. Shareholders would use this as an input in their assessment of corporate governance and in voting and engagement activities.

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