

The European Commission  
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## **VIEWS ON THE EU GREEN PAPER ON THE CORPORATE GOVERNANCE FRAMEWORK**

The Swedish Corporate Governance Board (the “**Board**”) hereby submits its views on the EU Commission’s (the “**Commission**”) Green Paper on the EU Corporate Governance Framework (COM(2011)164), (the “**Green Paper**”).

### **1 SUMMARY**

The Board is concerned by the regulatory development within the corporate governance area in the EU, not only with regard to the maintenance of a strong, dynamic cadre of Swedish and European listed companies based on private ownership in a market economy, but also the defence of the role of self-regulation in the securities market in countries where well-established such systems exist. In the opinion of the Board, any regulatory system which is too far-reaching and insufficiently adapted to each country’s circumstances risks damaging the dynamism and competitiveness of listed companies to the detriment of growth and the creation of new jobs in Sweden as well as in other EU member states.

The Green Paper contains proposals regarding highly detailed regulation, generally without any convincing justification for the proposed changes. It demonstrates a lack of knowledge and understanding of the different corporate governance systems of the individual EU member countries and focuses, without apparent structure, on very detailed rules, mainly applicable in an Anglo-American style corporate governance system but with less relevance in other jurisdictions.

The Board does not support any rule making at EU level based on the Green Paper. No evidence has been given in the Green Paper regarding the need for further EU regulation. The Board believes that regulatory action at EU level based on the Green Paper may unnecessarily risk damaging listed European companies and the European economy.

### **2 NO JUSTIFICATION FOR THE NEED FOR FURTHER REGULATION**

New and expanded rules concerning corporate governance should, as elsewhere, be based on a firmly established need for such regulation. In particular, it should be evident that the benefits of the new regulation clearly outweigh the costs. The Commission has not presented any such relevant background in the Green Paper. The highly limited and methodologically simplified set of interviews conducted within the framework of the production of the Green Paper, along with the consultation meetings organised by the Commission etc, cannot be regarded as sufficient basis for the far-reaching regulation proposals presented in the Green Paper.

Instead, the impression is that considerations regarding the governance of financial institutions, e.g. in the Commission’s green paper on corporate governance in the financial sector, have spilled over onto listed companies in general. One of the introductory passages in the present Green Paper, for example, states that corporate governance is a method of

dealing with “excessive risk-taking”, a view which echoes the discussions regarding financial institutions but seems largely out of place when discussing listed companies as a whole. The Board strongly questions whether poor risk management in a limited number of financial institutions justifies new and costly rules for all European listed companies.

### **3 MAINTAINING THE COMPETITIVENESS OF LISTED COMPANIES**

Swedish and European companies are competing in increasingly global markets, not least with companies from the emerging economies of the “new world”. This competition is growing ever tougher, and there are signs that Europe is beginning to fall behind. At the same time, companies from many new markets are considerably less encumbered by different kinds of regulation than their western competitors.

Listed companies also find themselves in competition for key resources such as capital, technology and management competence with companies operating under other models of company ownership, not least private equity companies. Such companies normally face less burdensome regulatory requirements in several areas, including accounting, financial reporting and corporate governance, compared to listed companies. There is a danger that the proposals in the Green Paper will reduce the competitiveness of listed companies even further when trying to attract strategic resources necessary for their operations, which might in turn reduce the incentives for growth companies to list their shares on the stock exchange.

In the long run, such a development threatens access to risk capital for dynamic listed companies with investment opportunities. This may in turn inhibit economic growth and hold back the creation of new jobs. Recent studies<sup>1</sup> suggest that the relatively weak market for IPOs on the American stock market in the last decade may have resulted in over 20 million fewer new jobs being created in the American economy.

Against this background, it appears counterproductive from a societal point of view to place regulatory burdens on Swedish and European listed companies without thorough justification, as these may lead to reduced competitiveness, both in global product markets and in relation to companies whose ownership form makes them unavailable for investment from the broader public. The opinion of the Board, therefore, is that the benefit to society of each new regulation must be carefully weighed against the costs that may be incurred as a result of reduced competitiveness for listed companies. The benefit-to-cost ratio requirement of any proposed new regulation should be set at a high level, with the burden of proof lying with those who advocate the regulation. We find such justification lacking in the Green Paper.

### **4 EXPANDED REGULATION IS NO GUARANTEE AGAINST FUTURE CRISES**

Corporate governance is basically about creating systems and procedures to ensure that companies are run in the interests of their owners, that the systems are well structured and that the governance is as transparent to the market and society as is feasible. The primary aims are to provide better opportunities for shareholders to exercise influence and to ensure that good governance contributes to the successful running of the company.

Poor corporate governance in the financial sector is frequently said to have played a significant role in the outbreak and development of the financial crisis, though this has not

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<sup>1</sup> See Weild, D. and Kim, E., Grant Thornton LLP: *A wake-up call for America*, November 2009, and *Market structure is causing the IPO crisis – and more*, June 2010 respectively.

yet been substantiated empirically to any great extent.<sup>2</sup> What we see now, not least in the ongoing debate within the EU, is that this notion is being applied without much opposition to listed companies in general, and there is even less evidence to support this assumption. There are individual cases in which poor corporate governance can be identified as one of the causes of the problems, but in the majority of cases the difficulties encountered by companies had other causes: the credit crunch, the collapse of markets and a global recession – often in combination with a lack of business acumen and bad management. But there is little evidence that it was companies with poor corporate governance – or companies acting under weak corporate governance regimes – that were hit hardest by the crisis, which should be the point of departure if it is the regulatory framework that is to be changed.

Many people also have exaggerated expectations of what can be done to prevent the failure of individual companies and avert economic crises through greater regulation of corporate governance. It is unrealistic to believe that good corporate governance can act as a guarantee against commercial failure. Key success factors for good business, such as business acumen, sound judgement, strong leadership and personal integrity, cannot be brought about by regulation. Instead, unnecessarily detailed attempts to prevent companies from failing through binding regulation run the risk of just creating an illusion of strong action and may even counteract its aims by resulting in unclear responsibilities or overly complex decision making processes.

## **5 OWNERSHIP RIGHTS AND RESPONSIBILITIES MUST NOT BE ERODED**

The market economy system is founded on free enterprise, where individual entrepreneurs are given the opportunity to set up and run companies in order to achieve their aims in the manner they consider the most appropriate within the framework provided by society. The rights of the owners and their associated responsibilities play a key role in this system. If company owners' rights to control their property are limited too much, there is a danger that the creativity, initiative and ambition that are the foundations of the market economy's unique capacity to create wealth will be inhibited. In the longer term, such a development might also reduce the incentive for private owners to work proactively and take responsibility for their companies, instead forcing society to assume this responsibility.

The latest crisis has certainly pin-pointed the problem of “too big to fail” more clearly than before, particularly with regard to banks and other financial institutions, but in some cases other types of company as well. This in turn has been used as a basis for questioning whether the owners of such companies always have the will and the ability to assume their full proprietary responsibility in accordance with the rules of the market economy and if not, whether that might in some cases justify the state stepping in to assume some of this responsibility. However, this is a problem that concerns very few companies, primarily within the financial sector, and a general set of regulations tailored to rectify the problems of a small group of companies risks causing great damage to the vast majority of stock exchange listed companies.

In this perspective, there is good reason to pay close attention to certain aspects of the regulations now being discussed within the EU. These include rules for the composition of boards, their size and how their work is organised, as well as rules prescribing how various functions within companies are to be organised and run and how the role of shareholders is to be discharged. In the green paper on auditing mentioned above, there is even a proposal to

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<sup>2</sup> For an example, see Mülbart. P.O.: Corporate Governance of Banks after the Financial Crisis – Theory, Evidence, Reforms, ECGI Law Working Paper No. 130/2009, April 2010.

transfer the responsibility for appointing auditors of listed companies from the shareholders to an external party, e.g. a supervisory authority.

The Board believes that many of these proposals, especially when all taken together, would lead to an erosion of proprietary rights, and thus by extension to an erosion of owners' responsibility for listed companies, with potentially damaging consequences for the workings of the market economy.

## **6 LESS REGULATION OF DETAILS, MORE REGULATION OF PRINCIPLES**

Corporate governance models vary considerably between the member states of the EU. Despite assiduous attempts by the Commission in the 1970s and 1980s, the EU has not managed to agree on a single, common corporate governance model. Roughly speaking, there are three different models, but a more detailed analysis reveals significant differences between all member states.

In principle, the largest part of the corporate governance rules covered by the Green Paper can be regarded as extensions of or add-ons on the corporate governance rules contained in each country's national company legislation. This means that, apart from the odd exception, common rules will not function satisfactorily in all legal systems. The notorious difficulties experienced by the Commission when trying to implement common and uniform corporate governance regulation in the member states of the EU is a clear illustration of this.

The Commission should therefore focus on spreading good examples of solutions to corporate governance problems, and where this is not sufficient, introduce more principle-based regulation, where the underlying aim of each rule is clear, but the exact formulation of the rule in order to achieve the aim can be adapted to the circumstances of each country. Such an approach would not only make it easier for the member states to introduce national regulations that fulfil the intended aims, it would also give more weight to the Commission's demands that the regulations be implemented. There is considerable reason to believe that this approach would ultimately lead to greater harmonisation within the EU of corporate governance on a principle level than the strategy applied so far, even if the details of the rules may vary significantly from country to country.

## **7 IN DEFENCE OF SELF-REGULATION**

In some circles, there seems to be a belief that self-regulation is too toothless an instrument for the effective regulation of corporate governance. In particular, the system of codes based on the principle of comply or explain has recently been called into question, with increasing calls for more mandatory regulation and tougher sanctions.

Legislation and other binding regulation, however, can only define minimum levels for what is acceptable corporate governance, a threshold that all companies must clear at all times. Codes based on comply or explain, on the other hand, can set the bar higher and define not only what is acceptable, but also what is good – and even very good – corporate governance. Hence they can impose a level that not all companies will be able to attain at all times, or even have reason to attain, but one which provides a goal at which to aim.

It is therefore the opinion of the Board that a combination of legislation and self-regulation, in the form of a code, based on the comply or explain principle, is the most effective system for regulating corporate governance. Law and other mandatory regulation set minimum requirements, while a code provides motivation for companies to develop and improve their corporate governance beyond these levels. In this respect, the development of corporate governance in Swedish companies in recent years provides a case in point.

Against this background, it is vital that Swedish self-regulation within the field of corporate governance can be retained and developed further. Every attempt to turn back the clock in this respect should be strongly resisted.

## **8 COMMENTS ON SPECIFIC ISSUES**

The numbered questions in the Green Paper are commented on separately in **Annex 1**.

Stockholm, 19 July 2011

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