

KOLLEGIET
FÖR SVENSK BOLAGSSTYRNING

The Swedish Corporate Governance Board

Annual Report 2007





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Foreword

Corporate governance in Sweden is improving as is confidence in the way in which companies are governed.

The Swedish Code of Corporate Governance has increased transparency concerning the way in which those companies encompassed by the Code are governed. The business world, through ambitious yet practically manageable self-regulation, has proved that detailed legislation is not necessary in order to improve the governance of Swedish listed companies. The Board survey of the views of the general public and professional attitudes to corporate governance also shows a certain measure of increased confidence that companies are being run in the interests of all the owners.

The Swedish Corporate Governance Board has now established its working methods. These are characterised by dialogue with the code companies and actors on the capital market as well as analyses of how the Code is working in practice. The Board, through a series of instructions and a continuously updated reference code on its web-site, has facilitated the management of parts of the Code which could otherwise have caused the companies unnecessary problems. The second year of corporate governance using the Swedish Code of Corporate Governance is almost at an end, whereby the Swedish Corporate Governance Board now presents its second annual report.

In the first part of the report we present the mission and work of the Board as well as the Board's evaluation in a number of current corporate governance issues. Then, following the same structure as last year, we give an account of our observations of the application of the Code and of the general understanding concerning Swedish corporate governance. The report ends with three articles which the Board feels are of interest in the Swedish debate on corporate governance. These articles were written by people outside the Board, and who accept responsibility for the content of their respective texts.

It is the hope of the Board that this annual report will help to promote understanding of the importance of good corporate governance and aid the continued constructive development work within Swedish corporate governance.

Stockholm June 2007

Hans Dalborg
Chair

REPORT OF THE BOARD

In this section the Board presents an account of the work carried out since the publication of last year's annual report and includes a discussion of current issues concerning the Code, its application and Swedish corporate governance in general.

The Mission of the Board

The mission of the Swedish Corporate Governance Board is to promote the positive development of corporate governance in Sweden. Its role is to ensure that Sweden continuously has a relevant, modern and efficient corporate governance code for listed companies, and it also promotes confidence in the governance of companies through various other measures and activities. The Board is also prepared to take part in international development work within the field.

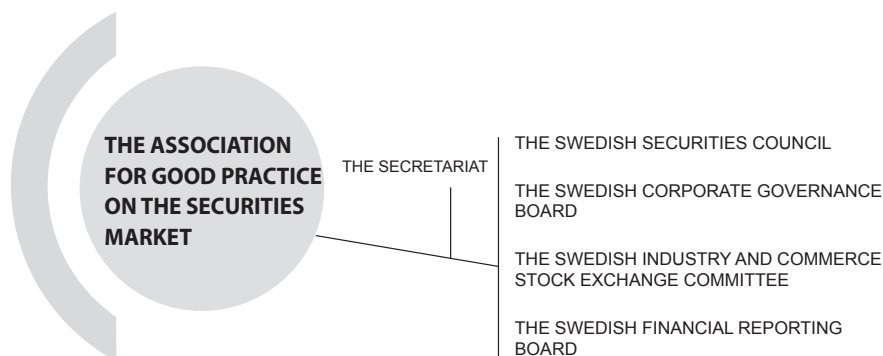
The Board is, together with The Swedish Securities Council, The Swedish Industry and Commerce Stock Exchange Committee and the newly-established Swedish Financial Reporting Board, a member of the Association for Good Practice on the Securities Market, which since autumn 2005 has assembled Swedish self-regulation in the securities market area. The association comprises a number of organisations within Swedish business and industry that are affected by these questions. See the diagram below.

The Board is responsible for determining norms for good corporate governance of listed companies in Sweden. It does this by ensuring the Swedish Code is appropriate, functional and continuously updated with regard to Swedish and international development. In order to form a

basis for this, the Board monitors and analyses the application of the Code. This is done through dialogue with users of the Code both in the form of seminars and meetings and also with the aid of various types of structured surveys. The Board closely follows general debate on the subject, changes to legislation and regulations concerning corporate governance, developments in other countries and academic research in the field. Based on these findings the Board considers immediate, more limited, modifications to the Code and also more fundamental long term adjustments.

The role of the Board is not to supervise, nor to judge, the way in which individual companies apply the Code. It is the task of the Stockholm Stock Exchange to decide whether those companies who are obliged to apply the Code do this in an appropriate way. However, neither does the Stock Exchange have a supervisory or judgemental role in the matter of how the companies choose to apply the Code.

It is the actors on the capital market – owners and their advisors – who make the final decision about whether or not the companies' application of the Code creates confidence and what consequences this will have for interest in investing in the company shares.





The Work of the Board

The composition of the Board is unchanged since last year. Hans Dalborg is the Chair and Lars Otterbeck the Deputy Chair. Lars-Erik Forsgårdh, Kerstin Hessius, Leif Lindberg, Anders Malmeby, Marianne Nilsson, Marianne Nivert, Michael Treschow and Anders Ullberg are ordinary members. Jukka Ruuska, CEO of the Stockholm Stock Exchange, is a co-opted member. Per Lekvall is Secretary and Lars Thalén Adviser for Communications.

The Board held four ordinary meetings and one extraordinary meeting during the year. The latter was devoted to Instruction 1-2006 concerning reporting on internal controls, issued 2006-09-05. Other matters dealt with were issues pertaining to the activities of the Board during the year. An overview of the main issues is presented below.

Instructions concerning the application of the code and the current reference code

The main attitude of the Board is that the Code shall be tried for some years and experience gathered after which a more detailed survey will be carried out and the issue of a possible wider application which would comprise smaller listed companies will be taken up and discussed. At the same time the Board is prepared to take immediate action to correct obvious difficulties and unclear points in the Code, and to modify it in the light of changes in legislation and other external circumstances, if and when this is deemed necessary.

In order to ensure clarity of communication with the market concerning the current content of the Code, the Board has introduced a series of instructions, serially numbered within the respective year of publication. When an instruction has been issued the code companies, the Stockholm Stock Exchange and other actors on the capital market are informed. The new instruction is then published on the Board web-site.

There is a current reference code always available on the Board web-site. This code contains the original text of the Code and with an additional note on every rule that has received an instruction. The note refers to the instruction in question and clarifies its main content.

The following instructions have been published to date. The full text is available on the Board web-site.

Instruction 1-2005: Statement on Board reports on internal controls concerning 2005. (2005-12-05)

This instruction referred to the general provisional solution for rule 3.7.2 which the Board issued in December 2005. This solution for the 2005 report stated that the Board could limit the report to a description of company organisation of its internal controls without a statement of how well this was functioning and with no demand for an audit.

Instruction 1-2006: Instruction for application concerning Code rules on reporting internal controls. (2006-09-05)

This instruction means in brief that the provisional solution according to Instruction 1-2005 was made permanent pending a future, more detailed survey of the Code and that a separate report would not be necessary for giving an account of the organisation of internal controls. This would comprise a special section in the Corporate Governance report.

Instruction 2-2006: Clarity concerning reporting deviations from certain rules in the Code. (2006-12-18)

In this instruction the Board clarifies a number of points in the Code which have given rise to misunderstandings in some quarters. This partly concerns rules about the possibility of being able to follow the Annual General Meeting by distance and the offer of simultaneous interpretation of the proceedings, where no explanation is necessary if the deviation is made according to the criteria in the rules. It partly concerns the rules on audit committees and remuneration committees, where boards who, with reference to their small numbers, choose to allow the board members to carry out the tasks of these committees, need not report this as a deviation nor give an explanation.

Instruction 3-2006: Altered application of certain rules in the Code due to new legislation. (2006-12-18)

In this instruction the conclusion is drawn that new regulations in The Swedish Companies Act and The Annual Accounts Act, concerning decisions made at Annual General Meetings on fees to board members and also guidelines for remuneration to the executive management, from and including report year 2006 will replace the corresponding rules in the Code. It should be noted that this is valid only for com-

panies affected by these laws. For other code companies, the Code rules will continue to apply.

Follow up of the application of the Code

The Board continuously carries out different types of surveys and makes summaries of how companies are applying the Code and how market confidence in the Code and in Swedish corporate governance is developing.

The Code Barometer is a regular survey of attitudes to the Code and to Swedish corporate governance. The purpose is to measure the fulfilment of the overall goal of the Code to contribute to raising the quality of Swedish corporate governance and thereby increase confidence in the listed companies in Sweden.

The first analysis was made during the autumn of 2005 in order to obtain a starting point for a comparison with later surveys. Then the first follow-up analysis was carried out at the same time during autumn 2006. The result of these surveys is reported in a separate section of this annual report and is also available on the Board web-site.

A deeper analysis of the corporate governance reports from 2005 has been made as a complement to the survey that was reported in the previous year's annual report. From this analysis it was apparent that some of the deviations that the companies mentioned in their reports were not in fact actual deviations from the Code but appeared so because the Code only dealt with half of year 2005. Furthermore, some of the deviations reported were due to lack of clarity about how the principle "comply or explain" should be applied.

A thorough assessment of the quality of the explanations given was made. Half of these were declared to be informative and well supported by fact while the remaining 50 per cent were thought to contain limited or no useful information.

During the spring of 2007 corresponding analyses of corporate governance reports were carried out as was done in the previous year. In addition a special survey was made of how, in practice, the companies have applied the Code rules on nomination committees. These surveys are also presented in a separate section of this annual report.

Dialogue with the market

The Board strives to maintain an on-going dialogue with the

companies who apply the Code and with the leading actors on the capital market. It does this by participating in the general debate in the field and also by participating in different types of seminars and meetings. In addition, the Board arranges its own seminars in order to familiarise itself with the experiences of the actors on the market and to focus on current issues in the field of corporate governance. Two such seminars were run during this last year.

Workshop 2006-12-05 The Board invited those working with the Code in code companies and those actors on the capital market who are affected by the Code to this workshop. The purpose was to stimulate discussion and exchange points of view and experience concerning current issues around the application of the Code. The following main issues were taken up for discussion:

- How has "comply or explain" worked to date? Are the explanations of any value?
- How can the Code contribute to better Annual General Meetings?
- Corporate governance reports – brief accounts of code application or a collecting place for all corporate governance information?
- How can Swedish companies improve their reports so as to avoid undeservedly low international corporate governance rating?

A summary of the discussion and a copy of the presentation slides from the meeting are available on the Board web-site.

Top level conference 2007-02-01. This conference was aimed at board Chairs in the companies that apply the code as well as owners and other leading actors on the capital market. The purpose was to discuss, in this forum, how developments on the capital market in recent years could affect Swedish corporate governance and what consequences this might have for the continued development of the Swedish Code.

The following questions were discussed after introductory speeches by guest speakers from the Swedish and international capital markets:

- New actors on the capital markets – new demands on owners, boards and management?
- The Swedish model for nomination committees – how will it work in the new owner environment?
- New investors with demands for new forms for an active



ownership role – how can we achieve well-functioning Annual General Meetings?

A summary of the discussion from this conference and a copy of the presentation slides are also available on the Board web-site.

Understanding of Swedish corporate governance abroad

As was stated in the report from 2006 the Board took certain initiatives last year due to difficulties of understanding certain aspects of Swedish corporate governance observed on the international capital market. These problems have caused Swedish companies to be rated low in international corporate governance ratings and to incomprehensible proxy voting of foreign investors at Swedish Annual General Meetings. In order to deal with this the Board compiled material that was sent out to the code companies with proposals for measures for improving information to the international market. The Board also initiated a dialogue with the Institutional Shareholder Services (ISS), one of the leading actors in the field, in order to explain Swedish corporate governance and indicate certain inaccuracies and misinterpretations in the methodology used for these rankings.

This work continued throughout 2006. The Board was given the opportunity, from a Swedish perspective to comment on the new methodology for corporate governance rating which was developed by ISS and their partner FTSE, where to a greater extent than previously an attempt had been made to take specific conditions on the various markets into consideration. Since the autumn of 2006 the Secretary of the Board has been part of the international Corporate Governance Advisory Committee that was created by ISS/FTSE for this development work.

The question of proxy voting by foreign investors at Swedish Annual General Meetings has been thoroughly discussed at both of the seminars arranged by the Board during the year (see previous section). These seminars were attended by representatives of both ISS and the leading Swedish actor in the field, SEB Merchant Banking.

The Board has also published the brochure *Special Features of Swedish Corporate Governance*, written by Sven Unger, business lawyer at Mannheimer Swartling, in which

Swedish corporate governance in general, and in particular the regulations and customs of Swedish Annual General Meetings, are explained in a concise and easily comprehensible way. A number of copies of this brochure have been distributed to all the code companies as well as a large number of actors on both the Swedish and the international capital markets. The brochure can be ordered, or electronically downloaded, free of charge, from the Board web-site.

Harmonisation of Nordic corporate governance

After the turn of the millennium, corporate governance codes were introduced in all the Nordic countries. These all originate from the same international corporate governance development of the last decades and show the same basic characteristics. However, each code has developed according to the conditions in each individual country, which means they are now too different to be applied over the Nordic borders.

This means considerable inconvenience for many companies, particularly against the background of the current integration of Nordic stock exchanges. It also counteracts development towards an integrated Nordic capital market, since it means that international investors must familiarize themselves with a special code for each country, and leads to less weight for the Nordic countries within the EU to act together in corporate governance issues.

With this background the Board, together with its newly formed Finnish counterpart The Securities Market Association has taken the initiative for a pan-Nordic discussion on the possibility of attaining increased harmonisation of Nordic codes of corporate governance. An initial meeting for this purpose with representatives from all the five Nordic countries was held at the end of June 2007.

Submission

The Board is a referral agency for government commissions and proposed legislation within its area of responsibility. During last year the Board made the following submission. The complete texts are available on the Board web-site.

The Swedish Ministry of Justice memorandum Ds 2006:6 concerning information requirements in listed companies

This memorandum dealt with a number of issues relating to

the Swedish implementation of the EU Commission Directive 2004/109/EG, also called the Transparency Directive. With reference to its area of responsibility the Board limited its answer to some reflections on the increasing burden of regulations for the listed companies and also some thoughts on the certification statement that was proposed to be introduced after the board and the CEO have signed the annual reports and the half yearly reports.

As to the first question, the Board expressed concern for the increase in the number of rules and the increasing bureaucracy this would lead to in the business world and pointed out the risk of decreased scope for self-regulation. They also urged the government to aim for restraint in the matter of increased legislation in areas where there is already a well-functioning self-regulation.

As for the proposed certification statement the Board pointed out that the Swedish formulation suggested appears rather more far-reaching than necessary according to the directive. Neither was it thought to have been convincingly investigated that such a far-reaching formulation was necessary in order not to lessen the board members' legal responsibility according to Swedish law. Therefore the Board recommended a deeper analysis with the aim of formulating a statement which meets, but goes no further than, the demands of the directive according to the original English text.

The Swedish Ministry for Industry, Employment and Communications memorandum Ds 2006:15 on internal controls in government administration

The Board decided to present a submission to this memorandum even though the issues raised are outside its field of activity. This decision was made since the Board, in its work with the regulations on internal controls of the Code, has valuable experience which it was thought could be useful when corresponding regulations for government departments are being formulated.

The main viewpoint presented by the Board was that, according to its experience, it would not be appropriate to formulate a regulation that made demands for an external statement of how the internal controls are functioning. The external report should instead be more transparent concerning how the respective authority organised the internal ma-

nagement and controls and how this work is carried out and developed, adapted to the specific area of activity.

If the regulation, however, should include demands for external statements about the functionality of the controls, the decision should not be implemented until a norm system has been developed, against which the internal controls can be measured and evaluated.


Swedish Ministry of Justice memorandum Ds 2006:11 concerning gender representation on company boards

The Board had earlier, directly to the survey committee which formed the basis of this memorandum, presented strong criticism to the idea of statutory quotas for gender balance on corporate boards. The comment compiled a summary of the opinions with the following main content:

The Code's and The Board's ambition to achieve a more even gender representation on company boards through self regulation is expressed in the Codes regulation that: "an equal gender distribution on the board is to be an aim". The Code at that point had not been in force for a full financial year, and according to Board opinion it would not have been right to take recourse to legislation before time had been given for self regulation to show effect in this matter. The Board stated the following objections to the proposal of the survey:

Since women are still greatly under-represented in operational leadership positions, which are the chief recruitment base for board appointments, it would be more effective to try to eliminate this imbalance.

If gender or other characteristics as a basis for increased diversity are prioritised over suitability for board membership there is a risk that boards will be divided into "A teams" and "B teams".

The representatives on a company board are elected by the owners and they are fully authorised to administer the property of the owners in the way they find most appropriate. Therefore it would be a far-reaching act of interference with the right of ownership to deny the owners their right to choose which people will be granted this authority. 



“The Code is functioning but there is room for improvement”

– The Board’s views on The Code and on current Corporate Governance issues

Two years after the introduction of the Code, the Board concludes both that the Code in the main is functioning well but that it needs constantly to be modified and improved, preferably in connection with an effort at harmonisation of the Nordic corporate governance codes.

Increased dependence on the external environment

At the Board high level conference at the beginning of 2007 it was concluded that corporate ownership and thereby demands on corporate governance in Sweden, is affected by more active global institutions and risk capital companies, profitable large companies pressing forward in a European and global structure and continuing growing oil capital. A Nordic stock exchange would create a basis for increased Nordic coordination within corporate governance.

An EU decision not to harmonise company law at present has been made. Still there is considerable interest in pursuing corporate governance issues within the EU, which has repercussions for Sweden. When this – as in the matter of the certification statement in annual reports – means that legislation in Sweden to implement EU directives chooses another, more far-reaching formulation than the proposed EU common wording (see page 5), it creates unnecessary problems for Swedish companies. Special Swedish regulations should be avoided as far as possible, so as not to obstruct the EU goal of an effective common European capital market.

The Code – a tool for better corporate governance

Good corporate governance regulations are a competitive advantage for the Swedish and Nordic stock markets and good application of laws and codes is a competitive advantage for private companies.

Swedish legislation can be maintained as less detailed and complicated for private companies if it is complemented by self-regulation based on the principle “comply or explain”, that permits tailor-made and transparent solutions. It is important that this line of reasoning is followed and the Board notes that the proposal for gender representation on company boards is not going to be acted upon at present.

One overall aim of the Code is also to increase confidence in the general public and the Swedish and international capital markets that the Swedish listed companies are being run

with the owners’ interests at the forefront. The year’s Code Barometer shows a certain improvement of the earlier low degree of confidence with regard to the general public, mostly in the group with the greatest share interest.

The Swedish Code of Corporate Governance shall be characterised by appropriacy and usability. Continuous improvements shall be made in the light of changes in the external business environment and experience gained. The strategy is to solve acute issues through Instructions to the Code (see page 3) and that a more thorough survey should be made in a few years, preferably in a common Nordic perspective.

The Board dialogue meetings with Code users have both facilitated the use of the Code and provided important input for the Board. This dialogue is complemented with a methodical evaluation which is presented in this annual report.

The Code is based on the principle “comply or explain”. The circumstances can, for a private company, be such that better corporate governance could be achieved by choosing another solution than that of the Code and explaining the reason for this. It is a healthy sign that companies, through finding their own solutions, apply the Code with the flexibility and critical judgement that is intended. If non-compliance can be attributed to the Code rather than to company specific circumstances the Board should consider whether the affected parts of the Code are well formulated.

The Code is functioning

The general impression of the year’s “corporate governance season” is that the Code companies’ information about their corporate governance practices is much improved compared with when the Code was introduced.

The year’s survey of the way in which the Code is being applied is a follow up of a corresponding survey of company reports from 2005, presented in the Board Annual Report 2006. The aim is to gain a firm, concrete idea of how the companies have applied the Code. This is part of the continuous evaluation of the Code by the Board and of considerations about possible modifications of the Code.

The results of the survey are positive. In the report from the previous year it could be concluded that after six months of practical application the Code had become fully accepted by the companies and in general was being applied in the

ambitious, yet at the same time flexible, manner that was intended. This picture was further confirmed by the survey of the year 2006.

More than one in three companies have found it reasonable to follow all the rules in the Code and around two thirds of the companies deviate by no more than one point. At the same time, the companies have shown that they do not feel slavishly bound by the Code but are prepared to make an independent decision on every rule. They do not hesitate to deviate and explain if they find this appropriate. It is also clear that the majority of the uncertainties and misunderstandings that occurred during the first year of application have largely disappeared through the Board's Instructions.

The explanations given for non-compliance have, however, not always been of a desirable standard. Deviations have occurred without explanation and explanations have been given with limited factual information. So far, this has not led to any measures being taken by the Stock Exchange supervisory function or to any focus in the media. A discussion of this would be welcomed.

Continuing debate on nomination committees

The Swedish Code rules on nomination committees as a forum for the shareholders to prepare elections at Annual General Meetings is, according to certain international observers, the most far-reaching example of practical ownership influence. Of course it is important to follow the way in which these rules function and their effects.

The rules for the composition of nomination committees have given rise to a number of deviations, chiefly in companies with concentrated ownership where large owners consider it natural that they are part of the nomination committee, and sometimes the Chair, while at the same time they are on the company board.

The year's analysis of how nomination committees were set up by Annual General Meetings in 2006 shows that 8 out of 10 companies appointed nomination committees according to a procedure decided by the AGM, while only 2 out of 10 appointed the nomination committee at the meeting. The boards were often represented by the Chair, and the owners by representatives of the larger owners.

At the Board high level conference in February 2007 the issue of the task and structure of the nomination committee was also discussed. Do the respective owner representatives represent a special owner or do all the members of the nomination committee represent all the owners? The fact that many members of the nomination committees have no personal experience of board work has also been pointed out as a potential quality problem.

The purpose of establishing nomination committees and procedures for appointing their members was not that the nominating committees should become a forum for business strategy negotiations between those owners who have nominated the committee members. Also, the situation where major owners nominate members shall neither be interpreted as that such members need to work for the nominating owner, nor that they shall exclusively represent this owner's interests.

According to the point of view of the Board the nominating committee should work in the interests of all owners for the good of the company. Candidates for nomination committees should be appointed with this in mind, and with the needs of the company as well as the need for experience of board work duly taken into consideration.

Furthermore, fears have been expressed in this debate that the nomination committee could be used to promote issues of company strategy and, contrary to the view of the Code, in practice develop into an independent governance




body. It is important to emphasize that the task of the nomination committee is only to prepare the election and decisions about remuneration for the board members – and in some cases the auditors – at the Annual General Meeting.

Questions concerning how nomination committees are appointed and their function will henceforth be at the centre of the debate on corporate governance in Sweden. There are reasons for the Board before a future survey of the Code, to thoroughly review these questions, especially before a potential broadening of the Code application to include small and medium sized listed companies is contemplated.

More informative Annual General Meetings

There has been increasing criticism recently about the amount of time taken up at AGMs for an account of the nomination committee's and the Board's activities, the presentation of principles for executive management remuneration, run-throughs of complex incentive programmes etc, while too little time is devoted to business matters. Even though this is only partly based on the demands of the Code, it was one of the main points for discussion at the Board's workshop in December 2006 (see page 4). There it was concluded that such accounts could in many cases be more concise and oriented towards key strategic issues while more formal questions could be presented in written form.

The experience of the AGMs of 2007 shows that companies, to a large extent, have adopted this point of view. Oral reports have been briefer and more informative, often referring to written texts for more detailed information. AGMs have in most cases not been unreasonably long, and most of the time has been devoted to business matters and those decisions that the AGM shall make.

One result of the altered ownership landscape is that more and more Code companies are owned by a greater number of foreign institutions that, to an increasing extent, will use their right to vote, often by proxy. This circumstance, combined with specific Swedish conditions such as voting for discharge from responsibility or the requirement of a 90 per cent majority for certain decisions, has caused the initiative from the Board as accounted in the previous section. Swedish companies must take their owners' and their advisors' circumstances into consideration in their investment contacts and allow sufficient time and information in order for them to reach a well-founded decision on their voting. This question is further illustrated in an article in the final part of this Annual Report, where a large international investor gives his opinion on how Swedish companies can improve the dialogue, especially with their foreign investors. 

SWEDISH CORPORATE GOVERNANCE 2006–2007

As stated in the previous section the Board conducts continuous surveys and analyses in order to follow up the way in which the Code is being applied and evaluates its functionality and effects on Swedish corporate governance. During the last corporate governance year the following surveys have been carried out. A summary of the result is presented in this part of the annual report.

- **The Code Barometer** is a regular survey of attitudes to the Code and to Swedish corporate governance with the aim of measuring the general achievement of the Code goal. A first measurement was carried out in autumn 2005, i.e. before the company reports on the first six months' application of the Code. The purpose was to obtain a starting point for comparison with later surveys. The first follow-up measurement was made in the autumn of 2006. The result of these surveys is presented in the summary on pages 11–17. A more detailed report can be found on the Board web-site.
- **Analysis of the Code's application 2006.** This survey, which was carried out on behalf of the Board by Nordic Investor Services, is a follow-up of a corresponding survey during the previous year. It is based on a survey of all code companies' corporate governance reports and aims to give a concrete and reliable view of how the Code is being applied as a basis for the Board's consideration of the Codes continued development. On pages 18–21 there is a summary of the result of the survey and the corresponding result from 2005.
- **Company reports on Internal Controls 2006.** This evaluation, too, that was carried out on behalf of the Board by board

member Anders Malmeby, KPMG, is a repetition of the corresponding survey in the previous year. Reporting on internal controls, according to rule 3.7.2, is the point in the Code that has caused most problems in practical application. Therefore the Board in report year 2005 issued a transitional provision, which meant considerable relaxation compared with the original rule. In September 2006 this solution was made permanent through the Board's Instruction 1-2006. Against this background it has been important for the Board to follow up the way in which the rule works in practice this year. The result is presented on pp 26–29.

- **Swedish nomination committees in practical application.** The point on which the Swedish Code differs most significantly from what is common in other countries, is that concerning the rules for nomination committees. The nomination committee is not, in Sweden, a board committee, but an organ appointed by the owners to prepare certain election questions for the AGM. While there is broad support for this model in Swedish business life it is not problem-free and has been questioned in both domestic and foreign debates. The Board thinks, therefore, that it is important to follow up and analyse how this model is applied and functions in practice. As a first step Nordic Investor Services, on behalf of the Board, analysed how nomination committees are appointed and composed before the Annual General Meetings in 2007. A summary of the result is presented on pp 30–35.



The Code Barometer

Attitude surveys on Confidence in the Code and in Swedish Corporate Governance

The Code Barometer is a regular survey of attitudes to the Code and to Swedish corporate governance. The aim of the survey is to measure how the Code is fulfilling its general goal of contributing to improved corporate governance in Sweden and thereby greater confidence in Swedish listed companies.

The Code Barometer consists of two parts. The first survey is directed towards the Swedish general public, while the second measures attitudes among leading actors on the capital market. The latter part is geared towards board Chairs and CEOs of code companies, private and institutional owners of listed companies and advisors, as well as intermediaries such as fund managers, chief analysts and corporate finance managers.

Two surveys have been carried out so far, in autumn 2005 and autumn 2006. The results of the respective surveys are summarised below. A more detailed report is available on the Board web-site.

The Swedish General Public

Purpose

The aim of the survey regarding the general public is to measure confidence, mainly among the share-holding general public, in how the listed companies are being run.

According to a survey by Sweden's Young Investors, which was carried out in autumn 2006, a total of 77 per cent of Swedish adults owned Swedish shares indirectly through funds including those administered by the Premium Pension Authority (51 per cent excluding Premium Pension funds) while 34 per cent directly owned shares in listed companies. The Swedish general public thus has strong direct or indirect ownership interest in stock exchange listed companies. Swedish public opinion of whether these companies are being run in the interests of the owners is therefore extremely important in attracting the savings capital of the general public long-term.

Methodology

The survey was carried out through telephone interviews within the frame of Sinovate Temo's telephone omnibus

surveys. The interviews were carried out during the period 20-29 November in both years.

Target group and sampling

The target group for the survey was comprised of Swedish adults over the age of 16, divided into three categories reflecting the degree of direct or indirect share ownership:

- Direct owners of shares in Swedish listed companies (may also own shares in funds).
- Owners of shares in funds but not direct owners of company shares.
- Non-shareholders.

The sampling of interview candidates was made by telephone. The number of people interviewed each year was 1 535 persons in 2005 and 1 038 persons in 2006. The breakdown according to share ownership category in 2006 was as follows:

	Number	Per cent
Direct owners of shares	322	31
Owners of shares in funds only	405	39
Non-shareholders	311	30
Total	1 038	100

This breakdown is in line with the result of the survey made by Sweden's Young Investors. The sample can therefore be assumed to be reasonably representative of the underlying target group.

This is a sample investigation and thus there could be some statistical uncertainty due to the size of the sample group. The sample size of at least 1, 000 persons in both years gives a statistical margin of error at a confidence level of 90 per cent for differences between the two survey occasions of around 0.10 scale units. Smaller changes can thus not be "statistically significant" at the chosen level of confidence.

Question and response scales

The following questions were posed:

Question 1. *How confident are you that Swedish listed companies are being run well and in the interests of all their*

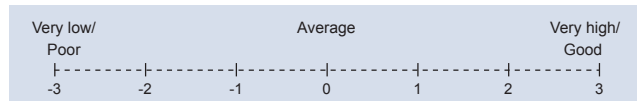
owners, by their boards and managements?

Question 2. In general, how well do you feel listed companies' boards and managements run companies in terms of:

- a) running the companies in a businesslike way in line with the interests of the general shareholding public?
- b) the openness, honesty and reliability of the financial information issued by companies?
- c) the standards of ethics expected of stock exchange listed companies?
- d) the level of remuneration for company executives in relation to the demands made on them?

The following scale was used for all the questions, however with somewhat different extreme alternatives depending on the wording of the question.

Response



Non-response cannot be identified in this type of survey since interviewees are recruited until the desired sample size has been achieved. There is, however, a degree of internal non-response as certain questions in the survey were left unanswered by some respondents. An account of this non-response is available in the full report on the Boards web site.

Result

Diagram 1. Average scores 2005 and 2006, total across all groups



In the diagram below we present changes in attitude from 2005 to 2006 in the form of an average of the answers for each question, the total for all respondents and divided into the respective sub-groups.

As is seen from diagram 1, attitudes have improved in all the questions. For the basic question about confidence in the way in which the companies are being run the average score has increased from -0.16 to +0.25, a clear and statistically significant improvement. The scores for questions 2a and 2b have also changed from a negative to a positive total balance. These changes are also statistically significant.

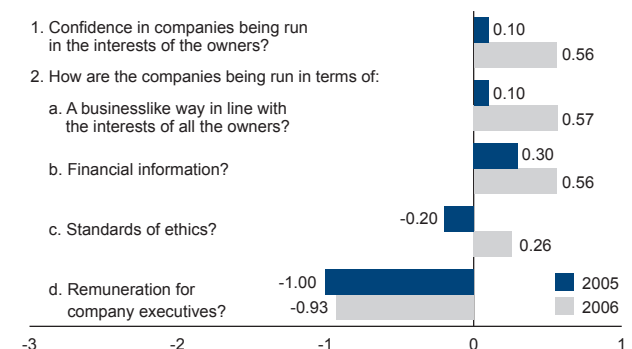
However, the scores are on the minus side when it comes to questions about the companies' ethical behaviour, and even more when it comes to remuneration for company executives, both in 2005 and 2006.

The result for the sub-group Shareholders can be seen from diagram 2. This is the group where improvements are most pronounced and the results for all questions, except the one about remuneration for company executives, are clearly on the positive side. This is particularly satisfactory since this is the sub-group in the survey that should be most familiar with current issues and which follows the development within Swedish corporate governance with the greatest interest.

With regard to the matter of remuneration for company executives, however, this group is also extremely negative to the same extent as last year and as other sub-groups.

Diagram 3 shows the corresponding result for the sub-

Diagram 2. Average scores 2005 and 2006, Shareholders group





group Owners of funds but not shares. For this group the result for all questions was negative in 2005. For the first three questions in the survey this has changed to cautiously positive attitudes in 2006, though still at low levels. With regard to remuneration for company executives this group is the most negative of them all.

The result for the sub-group that owns neither funds nor shares is seen in diagram 4. This is the most negative group and the attitudes in all questions are on the negative side, even if there has been a slight improvement since the previous year. The latter applies particularly in question 1, where the increase amounts to half a scale unit, the most obvious improvement for any question across all the groups. However, the attitude to remuneration for company executives is almost as consistently negative as it is in the other groups.

Summary

To summarize, the Code Barometer relating to the Swedish general public shows that

- confidence that Swedish listed companies are being run in the interests of the shareholding general public is quietly positive in most respects in total across all the groups. The main exception is the handling of remuneration for company executives, where confidence is extremely low.
- the attitudes in all respects except the last mentioned are

widely different depending on the degree of shareholder activity, from clearly positive overweight for direct ownership of stock to mainly negative for people who own shares through funds only or are non-shareholders. Attitudes to the handling of remuneration for company executives are, however, in the main just as negative in all the groups.

- an important improvement in confidence took place between 2005 and 2006 in all respects except the handling of remuneration for company executives. The more active the shareholding interviewees are, the stronger is this tendency.

The Capital Market

Purpose

The survey of the capital market is aimed partly at the code companies, partly at private and institutional owners, asset managers and analysts and other recipients of company reports on corporate governance. Its aim is to measure confidence in these actors that the companies are being run in the interests of the owners. Good confidence in this area is of course very important for the market's interest in investing in the companies and thereby for the companies' access to risk capital.

Diagram 3. Average scores 2005 and 2006, Owners of funds but not shares

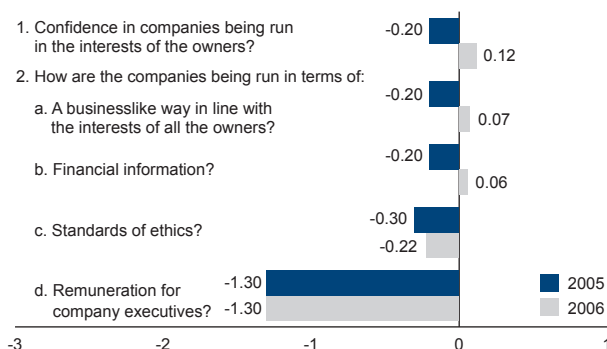
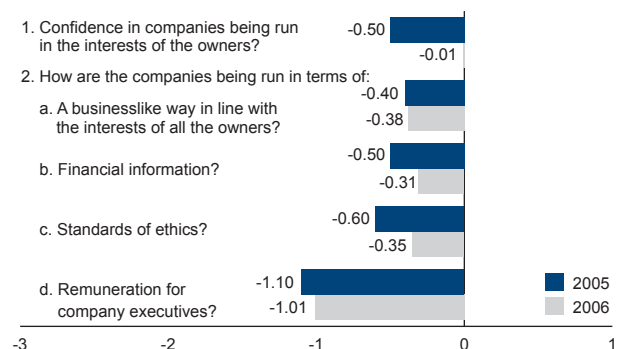


Diagram 4. Average scores 2005 and 2006, Non-shareholders group



Methodology

The survey took the form of a written questionnaire, distributed by email in mid-November 2006. Reminders were sent out by email and these were further followed up by telephone, letter and fax. The responses that were received up until 16 December were included in the resulting compilation.

Target group and selection of respondents

The target group for the survey was people in leading positions in companies and organisations that are affected by the Swedish Code of Corporate Governance, divided into the following categories:

Category 1 consists of major private and institutional shareholders. The survey includes the 40 largest actors, divided equally between these two categories.

Category 2 comprises other major actors on the capital market. These include owners and fund managers outside the large institutions, chief analysts at banks and stock brokerage firms as well as managers of large corporate finance departments. The largest actors in each category were selected, and they totalled 50 in number.

Category 3 is board Chairs and CEOs of those 99 companies that were applying the Code, according to the Stockholm Stock Exchange list, in November 2006. From these a total of 60 companies were chosen at random to be included in the survey, with the aim of achieving around 50 completed interviews. Half of the companies were represented by the board Chair, and the other half by the CEO.

Category 4 comprises Board Chairs and CEOs of those companies closest in terms of size to the code companies. These were defined as companies listed on the Stockholm Stock Exchange with a market capitalization of between one and three billion Swedish kronor on 30 September 2006. From this group of 59 companies, 50 were selected to take part in the survey. As in Category 3 an equal number of board Chairs and CEOs in each group were chosen for the survey.

These selection principles mean that, in practice, categories 1, 2 and 4 consist of all the major actors in each category. This in turn means that there is no statistical uncertainty and that the question of the statistical significance is irrelevant. (This does not mean, however, that there can have been no

other survey errors of the kind that can occur in other surveys e.g. – distortion due to non-response, measurement errors etc.)

However, the survey in Category 3 is liable to the same statistical risk as all sample surveys. Yet the sample is– and the number of completed interviews are– so large in relation to the whole target group that the statistical uncertainty is limited compared with other potential sources of error in a survey of this type. Hence the issue of statistical significance will not be further addressed in this part of the survey.

Question and response scales

The following questions were posed to the interviewees in all the target group categories. The first two questions measure the attitude of the interviewees to Swedish corporate governance as a whole both in absolute and relative terms, while the other questions focus on the level of importance people think the Code will have for the companies and their corporate governance.

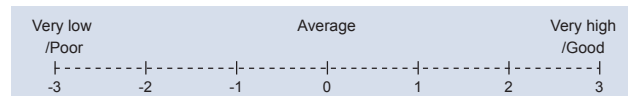
Question 1. *How confident are you that Swedish stock exchange listed companies are being run in the interests of the shareholders?*

Question 2. *How do you rate the quality of corporate governance in Swedish listed companies compared with those in other developed countries?*

Question 3. *How do you think the Swedish Code of Corporate Governance will affect the corporate governance of Swedish listed companies in the next few years?*

Question 4. *Do you feel that the Code has a generally positive or negative impact on the companies that are obliged to apply it?*

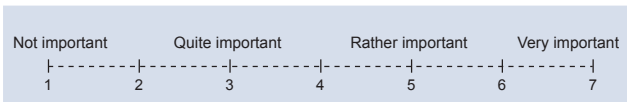
The following scale of response was used for all these questions, with, however somewhat different wording of the extreme alternatives depending on the wording of the question.



Question 5. *How important do you think the Code will be for facilitating Swedish listed companies' supply of risk capital in the future?*



Since this question is formulated in such a way that only different degrees of positive opinion can be given, a scale with only positive responses was used:



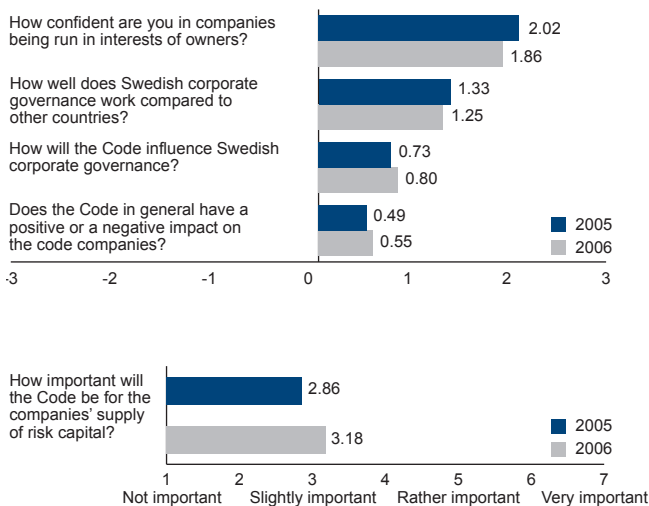
After each question opportunity was given for comments. Between four and ten interviewees submitted comments on each question. Finally, the following open question was posed, which led to a total of 22 comments:

Questio 6. *Do you have any other comments on the Swedish Code of Corporate Governance and its application? Please use this space to add any specific or general points. We would also welcome any comments on the activities of the Swedish Corporate Governance Board.*

Response

Of the total sample of 200 interviewees in the 2006 survey, 29 persons did not respond. Sometimes this was because the person in question had left their position and therefore was no longer a member of the target group. The actual sample thus consisted of 171 people. Of these, 116 interviews were

Diagram 5. Average scores 2005 and 2006, All categories except Non-code companies



actually carried out, which means the response rate was 68 per cent. A more detailed presentation of the breakdown by category of the non-responses is available in the complete report on the Board web-site.

Resultat

The diagrams below show the average scores for the responses received in 2005 and 2006, both for the group as a whole and for the individual categories. However, the additional comments received for each question and those on the final question 6 are not given here. For a presentation of these responses please see the more detailed report on the Board web-site. This also gives a detailed account of the breakdown of responses for each question.

Diagram 5 shows the average score for each question of estimates in 2005 and 2006 of all categories of respondents who were included in the surveys from both years. As seen, confidence is in general strong both for the companies being run in the interests of the owners and for Swedish corporate governance compared with that of other countries. In both these respects however, there was slightly less confidence in these questions in 2006 than there was in 2005. This can be assumed to be a reflection of the increasing debate about the quality of Swedish corporate governance, both in absolute terms and in relation to other countries.

Compared with these results, the confidence in the Code's impact on the companies and on corporate governance is more cautious, though still clearly on the positive side. Here too, attitudes have improved somewhat since 2005. This is also true of the question about the Code's importance for the companies' access to risk capital, where the attitude is certainly rather cool, but has changed a little from 2005.

Diagram 6 shows the result for question 1, broken down into target group categories. As is seen confidence in the companies being run in the interests of the owners is highest among the code companies' board Chairs and CEOs and, particularly in 2006, much lower among the owners and other actors on the capital market. Board Chairs/CEOs in non-code companies, who were only included in the 2006 survey, fall somewhere in-between. The greatest changes from 2005 to 2006 are a clearly weakened level of confidence on the part of the owners and a cautious improvement on the part of other

capital market actors.

If we distinguish between the board Chair and CEO groups (which is not shown in the diagram but is evident from the background data; see the attached tables in the report on the Board web-site) the differences are marginal for code companies. However, there is a clear difference in the non-code company category where board Chairs are more critical than CEOs – with average scores of 1.73 and 2.18 respectively.

As is seen from diagram 7 the owners, and to an even greater extent the board Chairs /CEOs in code companies, also became more critical in 2006 that they were in 2005, with respect to their attitude to Swedish corporate governance compared to that of other countries. However those actors in the “Other capital market actors” group are now more positive. It is difficult to find a simple explanation for this difference. Worsening attitudes in certain groups could be a consequence of increased focus on the issue of the quality of Swedish corporate governance in an international perspec-

tive, including reports of low scores for Swedish companies in international corporate governance ratings. On the other hand, it is difficult to see why attitudes in the category “Other capital market actors” are so clearly moving in the opposite direction.

Differentiation of the attitudes of board Chairs and CEOs in code companies shows that almost all the improvement stems from the CEO group, who raised their score from 0.71 to 1.25 while the board Chair category shows only a slight improvement. Among non-code companies the board Chairs in this question too are considerably more critical than CEOs with an average score of 1.08 compared to 1.60 for the CEO group.

The result for Question 3 is presented in diagram 8. With regard to confidence in the ability of the Code to influence corporate governance the scores are somewhat lower than for opinions on the quality of Swedish corporate governance, yet still clearly on the positive side. In this question we can see a clear increase from 2005 to 2006 for the board Chairs and

Diagram 6. Average scores Question 1 per target group category

How confident are you that companies are being run in the interests of the owners?

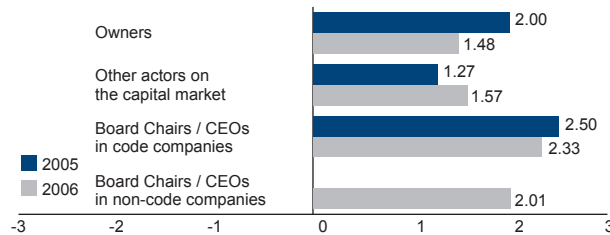


Diagram 8. Average scores Question 3 per target group category

How will the Code influence Swedish corporate governance?

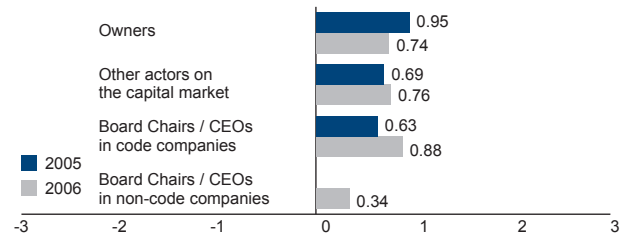


Diagram 7. Average scores Question 2 per target group category

How well does Swedish corporate governance work compared to other countries?

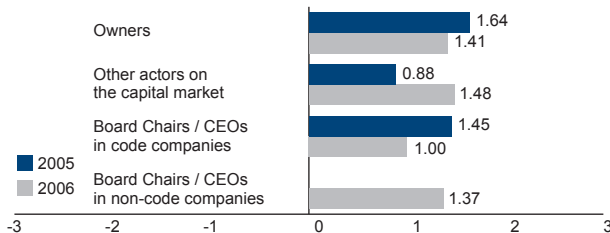
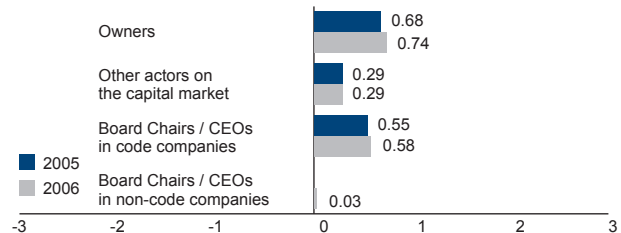


Diagram 9. Average scores Question 4 per target group category

Does the Code in general have a positive or a negative impact on code companies?





CEOs of Code companies and a small improvement also in the category "Other capital market actors". It is the CEO group in particular who have improved their rather cool attitude rising from 0.28 to 0.84, while board Chairs are at a similar level to 2005.

The "Owners" category, however, shows a negative attitude to the positive effects of the Code on corporate governance. Here too the "Non-shareholders" category shows a more negative attitude than on previous questions.

Diagram 9 presents the result of Question 4, whether people think the Code in general has a positive or negative impact on the code companies that are obliged to apply it. In this respect too, the attitude to the Code is sceptical, especially among "Other capital market actors". It may seem surprising that people in this group, who act to a large extent as advisors and "intermediaries" between owners and companies, have such markedly lower confidence in the usefulness of the Code for the companies than the latter two categories. There are few major changes to be seen here between 2005 and 2006. Neither are there any major changes between views of the code companies' board Chairs and CEOs in this respect.

Finally the "Non-code company" group shows a more sceptical attitude to the Code with an average score of near zero. Here too the difference between the views of board Chairs and CEOs is marginal.

Diagram 10 presents the result of Question 5 about opinions of the importance of the Code for the companies' future risk capital supply. Note that here the scale of measurement differs from that of the other questions, since the whole scale is on the positive side. Due to lack of space we show only the

scale degrees 1–5 in the diagram.

The average score of this question across all the groups is around 3 on a scale of 1 to 7, which can be expressed as "a certain" impact. Neither is there a great difference between the categories. The significant deviation from this pattern is the marked increase in the groups board Chair/CEO in the code companies from 2005 to 2006. This stems almost exclusively from the board Chair category that raised its average score from 3.0 to 4.1.

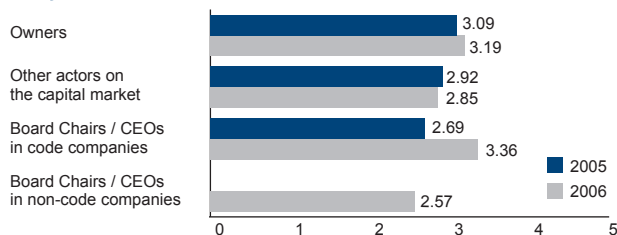
Summary

In summary, the survey shows with respect to the capital market, that

- confidence in corporate governance in Swedish listed companies is generally high, both in absolute terms and in comparison with other countries. However, there are tendencies towards a decrease in confidence from 2005 to 2006, most noticeable among board Chairs/CEOs in code companies. On the other hand, the "Other capital market actors" group shows an increased confidence in these respects (though from considerably lower levels than the other groups).
- the attitude to the impact of the Code on Swedish corporate governance, and on companies and their risk capital supply, is more cautious, though clearly on the positive side. There are also clear tendencies here towards a positive change from 2005 to 2006. This is true of all three respects which were investigated and in the main common to all groups.
- all these change tendencies are slight. Further investigation is needed, therefore, before any definite conclusions can be drawn. ◀

Diagram 10. Average scores Question 5 per target group category

How important will the Code be for the companies' supply of risk capital?



Application of the Code 2006

This section is based on a survey carried out by Nordic Investor Services on behalf of the Board. The survey is a follow-up of a similar survey of the companies' reports from 2005, presented in the Board Annual Report 2006. The purpose of the survey is to obtain a concrete and reliable view of how the companies have applied the Code as part of the Board's continuous evaluation of the Code and consideration of possible modifications to the same.

It is important to emphasize that it is not the task of the Board to evaluate, neither to offer opinions on, the way in which individual companies choose to apply the Code or in general organize their corporate governance. These are the tasks of the Stockholm Stock Exchange, which ensures that the Code is applied according to the Stock Exchange listing agreement, and the actors on the capital market in general when they evaluate the companies' corporate governance in connection with investment decisions.

Purpose and Methodology

The Board's purpose in analysing the companies' application of the code is only to gain background information in order to be able to assess how well the Code is functioning, whether there are parts of the Code that the companies find to be irrelevant or complicated to apply or are difficult to interpret. Such assessment forms the basis of the work of the Board in respect of the continued development of the Code.

The basis of the analysis has mainly comprised the companies' own reports of how the Code is being applied in the frame of those corporate governance reports that, according

to the Code, shall be attached to the Annual Report. When necessary this has been complemented with information from other sections of the annual reports, company web-sites, minutes of AGMs and in some cases through interviews with representatives from the companies.

The object of the analysis is those 101 companies that were registered as code companies on the Stockholm Stock Exchange at the beginning of 2006. However, due to the time factor it was not possible to wait for all these company reports before putting together this analysis. Therefore the analysis is limited at this point to the 91 companies which were able to supply their corporate governance reports on 20 April 2007.

Company Reports on Corporate Governance

According to the Code the code companies shall attach a corporate governance report with specified content (the Code section 5.1) to the Annual Report. These reports need not be reviewed by the auditor, but if this has been the case it shall be stated. In the corporate governance reports it shall be stated that the company applies the Code and there should be a brief description of how this has been done during the most recent financial year. Deviations from individual rules shall be reported and explained.

All the companies in the analysis have submitted a corporate governance report. In one case, however, this was not within the frame of the official printed Annual Report but was published on the company web-site. All the companies except two explicitly state that they apply the Code; but it is implicit that this is also the case in those two companies.

Five companies state that the reports have been reviewed by the auditors while 77 companies state that this has not been the case. In the remaining 9 cases it is not stated whether or not the reports have been audited, which is not completely in agreement with the stipulations of the Code.

All the companies, except one, which chose different solutions than those recommended by The Codes for individual rules, have explained this clearly, in many cases compiled in a separate section or in the introduction to the corporate governance reports, see table 1. In the case that deviated, the deviation was not explained clearly but could only be read "between the lines" in the report. This is, however, an impro-

Table 1. How are deviations presented?

	No of companies		Per cent	
	2006	2005	2006	2005
No deviations reported	33	18	36	24
Compiled in a separate CG Report	21	20	23	27
Introductory section in CG Report	26	19	29	26
Presented recurrently in CG Report	10	11	11	15
Can be read "between the lines"	1	6	1	8
Total	91	74	100	100



vement on the previous year when 6 companies, around 8 per cent of all the companies, did not explain their deviations in a clear way

According to the Board Instruction 1-2006 the report on internal controls according to the Code regulation 3.7.2 from report year 2006 need only contain a description of how internal controls are organised, without a statement of how well they are functioning and with no demand for an audit. The report shall be included as a separate section in the corporate governance report.

All the companies in the survey have submitted a report on internal controls, in one case though only on the company web-site. The majority, 83 companies, have followed the Board Instruction and included this presentation in the corporate governance report, while 7 companies chose to submit a separate report. A more detailed examination of how the companies have applied the Code rules on internal controls is presented in the penultimate section of this Annual Report.

The Companies' application of the Code rules

The Code is founded on the principle of "comply or explain". This means that companies that apply the Code can choose either to follow individual rules as they are stated in the Code or, if it is felt to be appropriate, to use other solutions which

are more suited to their company's specific conditions. When they do the latter the company must explain their motivation for choosing an alternative solution.

As seen in Table 1. 33 companies, corresponding to 36 per cent of all the companies in the survey, have chosen to follow the regulations in the Code. This is an increase from the previous year's figure of 24 per cent.

The other 58 companies chose their own solutions to one or more of the rules in the Code. Altogether these companies have made 106 deviations from 16 of the Codes rules (see diagram 1), that is on average 1.8 deviations per company. In the previous year the corresponding figure was 167 deviations by 66 companies from 31 rules, an average of 2.5 per company.

Diagram 2 shows how many companies have made a different number of deviations in 2005 and in 2006. From the dark blue bars we can see that a total of 59 companies, around two thirds of the total, made no more than one deviation and that no company made more than four deviations in 2006. This suggests that the Code is on the whole functioning well and that many companies have been able to apply it without too much difficulty. This is also a clear improvement on 2005, where uncertainty in interpretation and other misunderstandings of certain rules led, in some cases, to more deviations being reported than had actually been made.

Diagram 1. Total number of deviations

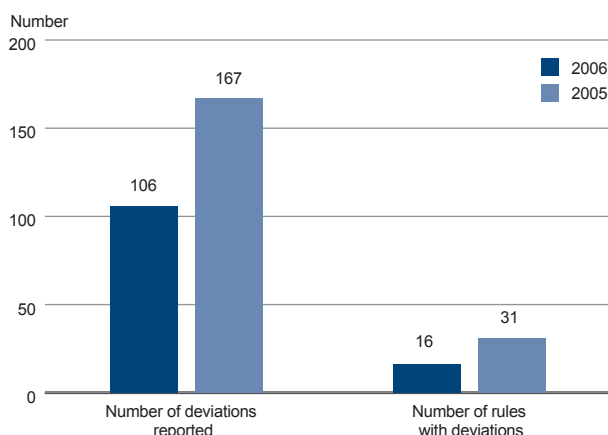
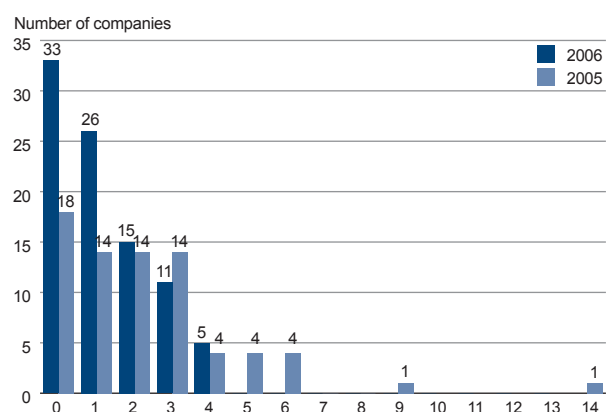


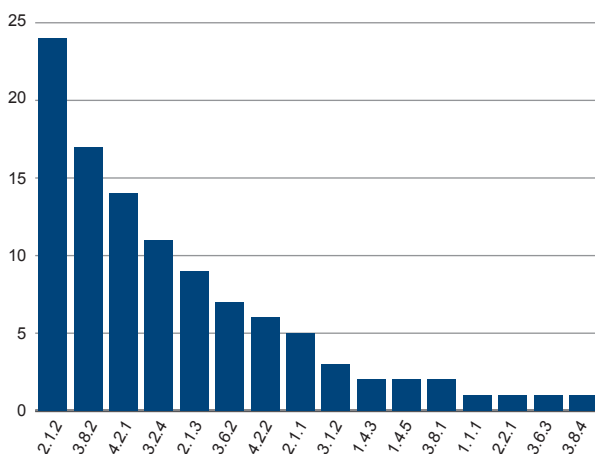
Diagram 2. Number of deviations per number of companies



In diagram 3 we see how the deviations presented in 2006 were distributed according to the Code rules. The rule which shows most deviations was rule 2.1.2 concerning the composition of the nomination committee. Those companies that chose to deviate from this rule were the ones with concentrated ownership where the AGM has found it appropriate for large owners who are on the board to also be members of the nomination committee. In a number of cases this has led to a greater number of board members on the election committee than the Code stipulates. In some cases such board members have also been chosen as Chair in the nomination committee, which is not to be done according to the Code. This can be viewed as an example of when the rules of the Code are not appropriate for the circumstances in individual cases and therefore other solutions are reasonable.

Next, those rules that have had the most deviations are the rules concerning audit committees (3.8.2) and remuneration committees (4.2.1). With respect to audit committees the most common reason is that without explicitly referring to the small number of board members, companies have chosen to allow the entire board to discharge the tasks of the audit committee and also that in the smaller boards it is considered more effective to have only two members on the

Diagram 3. Number of deviations per regulation



audit committee. In the remuneration committee the main reason for deviation is that people who, for other reasons (important owners, wide experience etc), are considered suitable to be on the committee, do not fulfil the demands of the Code for independence from the company and the executive management. Here too we have examples of cases where it can be appropriate to find alternative solutions to those of the Code.

Regulation 3.2.4 concerns the board members' independence from the company and the executive management. Eleven companies have deviated from this, usually because they have given experience and competence priority over independence from the board. This is particularly valid in some cases where the only criterion that leads to independence is the "twelve year limit".

Regulation 2.1.3 concerns the time period for the announcement of the composition of the nomination committee, where for some companies it was not practically possible (they had no venue for the AGM) to be able to do this within the stipulated six month limit.

Regulation 3.2.6 concerns the certification statement, which some companies consider in principle incorrect or superfluous (but which will be validated from 1 July 2006 in an even more stringent version).

Finally seven companies have chosen not to apply regulation 4.2.2 on the presentation of and decision on remuneration to the executive management at the AGM. This may seem surprising since there is a similar law which came into effect as of 1 June 2006.

Explanations of deviations

If the principle of "comply or explain" is to work as planned it is important that deviations are explained in an acceptable way. It is up to the recipients of company reports to determine what is acceptable, and these are mainly the company owners and other actors on the capital market. However, it can be said in general that explanations, in order to fulfil their function, should be concrete, informative and as far as possible based on the individual company's specific condi-



tions. Airy –fairy, general arguments with no connection to the situation of the company in question have little informative value.

The explanations to deviations made seem so far to be the point where the Code has functioned less satisfactorily. Of the 58 companies that reported deviations in 2006, 4 gave no explanation at all and a further 9 explained some, but not all, of the deviations see Table 2. As the table shows, the result was in the main the same in the 2005 survey.

A survey of all the deviations presented in 2006, with an attempt at subjective evaluation of the explanations given, gave the following result (figures from 2005 in brackets):

- For 23 (28) per cent of the deviations there was no explanation at all.
- In 24 (32) per cent of cases the explanations have been deemed to have limited or no informative value.
- For 53 (40) per cent the explanations had reasonable informative value. These have usually stated owner responsibility, experience, effectiveness or company specific conditions as reasons for deviation.

Obviously there is room for continued development in this area.

Table 2. Are the explanations for deviation clear?


	No of companies		Per cent	
	2006	2005	2006	2005
Yes	45	50	78	82
No	4	2	7	3
In some cases	9	9	15	15
Total	58	61	100	100

Summary

In the previous year's report it could be concluded that the Code after the first six months of practical application had gained clear acceptance among the companies and that in all important respects it was being applied in the ambitious yet flexible way intended. This view remains and is further confirmed by the survey of 2006. More than every third company has found it reasonable to follow all the rules of the Code,

and around two thirds of the companies deviate on no more than one point. At the same time the companies have continued to show that they apply the Code with the intended flexibility and do not hesitate to deviate and explain if they find this warranted. It is also clear that the majority of the uncertainties and misunderstandings that occurred during the first year of application have now disappeared.

The question where most companies chose other solutions than those of the Code was the composition of the nomination committee. This is especially true of companies with concentrated ownership where large owners often find it natural to be part of this committee, and even sometimes take on the role of Chair, even though they are on the board of the company. Next are the rules on audit and remuneration committees, usually due to the fact that the entire boards prefer to deal with corresponding questions or that the need for competence and experience is given priority over the independence of the members. These three rules together are responsible for about half of all deviations reported.

The aspect of the application of the Code that has so far functioned less satisfactorily is that dealing with the explanations given for the deviations presented. Four companies gave no explanation whatsoever and a further nine companies explained some but not all of the deviations presented. The quality of the explanations given is also varied. While around two thirds of the total were judged to give reasonable information this was not deemed to be the case in the remaining third. 

Company reports on internal controls

How have the companies reported their internal controls for 2006? What has changed since the corresponding reports were presented in 2005? In order to answer these and other questions, a survey was made of the code companies at the turn of the year in 2006.

Summary

- During 2006 one in three companies ran a special project in order to further develop their internal controls. This is a clear increase compared to the previous year when one in five companies initiated or made decisions on special activities.
- All the companies in the survey have presented a report on internal controls. More than three quarters of the companies have, in accordance with the relevant Board Instruction, included the report on internal controls as a section of the corporate governance report, while others presented the report separately.
- The structure of the reports follows in most cases the instructions of the Confederation of Swedish Enterprise and FAR (the institute for the accounting profession in Sweden) in their report instructions, which makes them much easier to comprehend. Compared to the previous year the number of companies that follow the report instructions has increased somewhat.
- All the companies except one have adopted the Board instruction that the report need not contain a statement about how well internal controls have functioned during the recent financial year.
- The international framework for internal controls, COSO, has had greater impact. 40 per cent of the companies state explicitly that they make use of it. In the previous year the corresponding share of companies was 26 per cent.
- Almost all the companies have met the requirement of the Code to, in those cases where there is no special review function (internal audit), evaluate the need for such a function and motivate their standpoint in the internal controls report. For three companies there are no comments and this deviation from the Code has neither been explained in the internal controls section nor in the corporate governance report.
- With the exception of one company none of the 91 companies in the survey have had the reports on internal controls checked by an auditor.
- The level of ambition of the reports has risen considerably since 2005. This is particularly true of the larger companies, where the number of companies with a high level of ambition for their reports has substantially increased.
- The medium-sized companies, too, have raised their level of ambition for reports. However, the level of ambition in this group is clearly lower than that of the large companies, which was also the case the previous year.
- The report on internal controls section usually comprises one page and the most comprehensive are around 2.5 pages. This was also true in the preceding year except that then the most comprehensive report comprised 4 pages. With the standpoint that it is content and not volume that is important, we can note that reports of companies with a high level of ambition usually have a text volume of 1.5–2.5 pages.

Survey

The aim of this survey is to get some idea of how companies have applied the rules in The Swedish Code of Corporate Governance (the Code) with respect to the 2006 board reports on internal controls for financial reporting. The survey is a follow up to a similar survey of 2005, which was presented in The Board Annual Report 2006.

Code companies shall each year, starting in 2005, present a report on internal controls concerning financial reporting. According to the Code, and Instruction 1 - 2006 from The Board, the reports shall present a description of how internal controls are organised and this shall be done using the guidelines drawn up by working groups from The Confederation of Swedish Enterprise and FAR. The reports need not contain a statement about how well the internal controls have functioned during the previous financial year. Auditing the reports is voluntary and the report shall comprise a special section in the corporate governance report (in 2005, a separate report was required). It shall be stated whether the internal controls section has been reviewed by the company auditor. If the company does not have a



special audit function (internal audit) the Code states that the board shall evaluate the need for one every year. In the report on internal controls the board should motivate their attitude.

The object of the survey is the 101 companies that were registered as code companies on the Stockholm Stock Exchange at the end of 2006. It has not been possible to wait for all the company reports as supporting material for this survey. Therefore the survey has been limited to the 91 companies whose corporate governance reports were available on 20 April 2007. Where applicable the companies are divided below, on the basis of which list they are on at the Stockholm Stock Exchange, into "Big-cap companies" or "Mid-cap companies". For practical reasons two companies who are in the "Small-cap company" category have been included in the latter category.

Result

More detailed information for some of the areas mentioned above is given below.

Information in the corporate governance reports or given as separate reports

Table 1 shows that all the companies in the survey have presented a report on internal controls. The information has been presented either in corporate governance reports, in accordance with the Board Instruction 1-2006, or as a separate report on internal controls.

Structure of the Reports

All the companies in the survey have presented a report on internal controls. The structure of the reports follows in most cases the guidelines of the Confederation of Swedish Enterprise and FAR in their report guide, which facilitates partly the reading of the individual reports and partly a comparison of the companies. Compared with the previous year the number of companies that follow the report structure in the guidelines has increased somewhat.

Table 1. Method of presenting information on internal controls

	Big-Cap companies		Mid-Cap companies		Total	
	Number	%	Number	%	Number	%
Companies with information on internal controls as a separate section in the corporate governance report	54	96	30	86	84	92
Companies with a separate report on internal controls (outside the corporate governance report)	2	4	5	14	7	8
All the companies in the survey	56	100	35	100	91	100

Table 2. Structure of the reports

	Big-Cap companies		Mid-Cap companies		Total	
	Number	%	Number	%	Number	%
Companies that followed the recommended report structure in 2006	47	84	29	83	76	84
Companies that followed the recommended report structure in 2005	33	77	23	74	56	76

Table 3. Companies that explicitly state that COSO is used in their work

	Big-Cap companies		Mid-Cap companies		Total	
	Number	%	Number	%	Number	%
Companies that refer to COSO 2006	26	46	10	29	36	40
Companies that refer to COSO 2005	13	30	6	19	19	26

Statements with value judgement

According to the Board Instruction 1-2006, published in September 2006, the report need not state how well the internal controls have functioned during the previous financial year. In one case the company chose to present what was seen as a value judgement by stating that "there are effective and appropriate internal controls" and that "we judge that we have satisfactory controls".

Utilization of the international control framework

COSO For 2006 a large number of companies explicitly state that in their work they make use of the internationally well known framework for internal controls, COSO. With regard to the fact that the increase is relatively large it seems that this framework is gaining impact.

For further information about COSO please see the guidelines that the Confederation of Swedish Enterprise and FAR issued in October 2005 (The board report on internal controls regarding financial reporting, guide to The Swedish Code of Corporate Governance, published by working groups from the Confederation of Swedish Enterprise and FAR, 17 October 2005).

Evaluation of the need for an internal audit function

Most companies that do not have an internal audit function have evaluated the need for this and motivated their decision in the internal controls report, just as the Code prescribes in rule 3.7.3. For three companies there were no comments on this in 2006, and this was not reported as a deviation and no explanation was given for the deviation either in the internal controls section or in the corporate governance report.

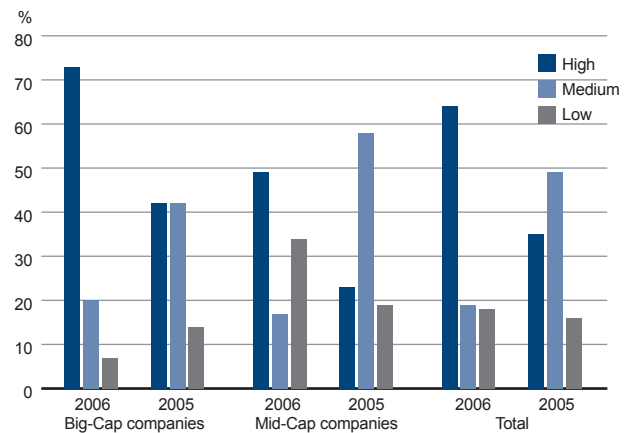
In the previous year there were two companies on the A-list (generally corresponding to the present Big-cap category) and three companies on the O-list (the present Mid- and Small-cap categories) who did not report whether they had made such an evaluation. One of the companies

referred to the fact that the forms would be worked through during the coming year. This must be seen as an explanation ("explain"), and so they did follow The Code. The other four companies gave no explanation.

The level of ambition in the reports

The level of ambition of the companies in their reports on internal controls has been assessed. The reports have been divided into categories High, Medium and Low. Those reports in the High category are characterised by rich content/substance, transparency and good connection to the business. Those in the Low category are characterised by scant content with information that is too standardised.

The assessment following these criteria necessarily contains a measure of subjectivity and the accuracy in the result of the survey shall be judged with this in mind. A comparison with the corresponding survey in the previous year is also presented – see diagram below. ◀





Swedish nomination committees in practical application

The “*Valberedning*” (*nomination committee*) is perhaps the most important innovation in The Swedish Code of Corporate Governance. Unlike its corresponding *nomination committee* in several other countries the Swedish nomination committee is not a board committee but the AGM tool for the preparation of certain questions around elections. It is the owners that appoint and to a large extent fill the nomination committee, and it is to the owners at the AGM that proposals are submitted. This important difference is based on the fact that the owners, according to the Swedish corporate governance model, have a stronger position than in the Anglo Saxon system. It would be alien to Swedish corporate governance if the board, through a committee, nominated their own successors.

Background

Almost all the code companies in 2006 appointed nomination committees according to one of the two alternative methods described by the Code, and the work in the nomination committees seems to have worked well on the whole. This has meant that the work of nominating the board Chair and other members is done today in a much more structured and transparent way than was the case only a few years ago.

At the same time the model, as is apparent in the section “Current Corporate Governance Questions”, is not problem free. It has been questioned, for example, whether the composition of the nomination committee has always been such that the demands for experience of board work and knowledge of company activities and strategy have been satisfactorily met. Furthermore, there has been a debate about the way to appoint nomination committees: whether this should be done directly by the owners at the AGM or at a later date according to a procedure decided upon by the AGM and whether the members of the nomination committee represent individual owners or all the owners. The fear of the nomination committee in practice developing into a new power organ, where the owners in that group can use their position to exert influence in questions that are not the task of the nomination committee, has been voiced.

Purpose and Methodology

In order to give the market a better factual basis from which to more effectively debate these questions the Board commissioned a systematic mapping of how the rules on nomination committees were applied in practice in 2006. The survey was carried out by Nordic Investor Services on behalf of the Board. The survey is based on the same 101 companies as in the survey of how the Code has been applied (see page 18) with the exception of one company that was not listed at the occasion of the last AGM and for which information about the nomination committee was not accessible. A total of 100 companies are thus included in the survey.

The data for the survey was compiled from open sources such as minutes of AGMs, corporate governance reports and web-sites, in some cases complemented by information direct from the company or the election committee. Thus it consists only of the conditions that can be read from such sources. No attempt has been made, with the help of interviews with individual members, to gain insight into how the inner work has been carried out in the nomination committees.

Two main questions with some sub-questions have been analysed:

1. Appointment of nomination committee – according to which model was this done, did the AGM decide on criteria for the composition of the nomination committee, number of members and who is the Chair?
2. The composition of the nomination committee – backgrounds of people on the committees and what about gender allocation?

Appointment of nomination committees

Four companies have not appointed a nomination committee according to the Code model but chosen other solutions for the nomination of board members (Table 1). All of them have given an explanation for this, usually referring to the fact that company ownership is so concentrated that a formal nomination committee has not been considered necessary.

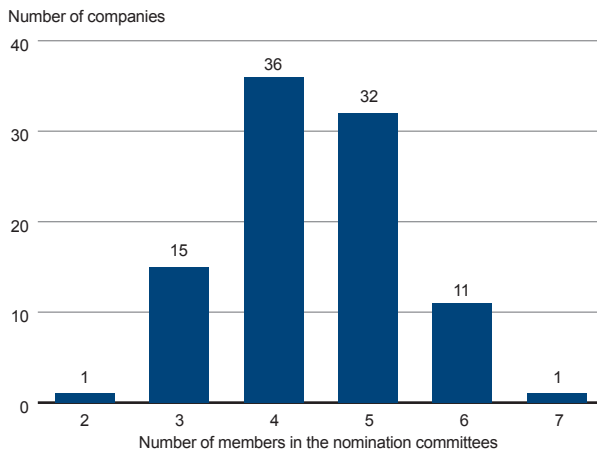
19 of the other 96 companies have appointed nomination committees – directly at the AGM – while in the remaining

77 companies the AGM has decided on a procedure for appointment at a later date. In the latter case it is natural that the decision also includes those criteria which will apply for the appointment, but this is not necessarily the case when the nomination committee is appointed directly by the AGM. However, in 5 of these 19 companies appointments were made using criteria for nomination committee appointment which were established at the AGM, while this was not the case in the other 14 companies.

The average size of nomination committees has been 4.4 persons divided into different classes of size as in diagram 1. As is shown, one company chose to deviate from the demand of the Code for at least three members in a nomination committee, which they did because, for reasons of time-saving, they preferred an "informal" nomination committee of only two members. Otherwise the normal size of the group is four to five members.

All the nomination committees except one have appointed a Chair (which is not an explicit demand of the Code). Of those 95 Chairs appointed, 30 have been members of the company board – 17 board Chairs and 13 other members – 61 expressed representatives for owners and 4 with no known connection to the owners or the company (Table 2). 86 per cent of Chairs were men and 14 per cent women.

Size of the nomination committees



Composition of the nomination committees

Table 3 shows the composition of the nomination committees with a breakdown of board members and non-board members. Of a total of 425 members in the nomination committees examined 25 per cent were board members. Of these 70 per cent were board Chairs and the other 30 per cent were other members.

Of the 320 non-board members a clear majority, 97 per cent, are appointed representatives¹⁾ for the large owners of the company. Of the remaining 11 non-board members 5 are appointed representatives for smaller shareholders, while in the other 6 cases no appointed or in other way known connection to the company owners could be concluded.

Of the 309 representatives of large owners 84 per cent represent Swedish owners and the remaining 16 per cent represent foreign, usually institutional, owners. Major international investors, active on the Swedish market, have thus

Table 1. Appointment of nomination committee

	Number	Share
No formally appointed nomination committee	4	4%
Nomination committee appointed at AGM	19	19%
Decision on procedure for appointment later	77	77%
	100	100%
Of those "appointed at AGM" – Did the meeting establish criteria?		
Yes	5	26%
No	14	74%
	19	100%

Table 2. Who is the Chair?

Totalt antal VB-ordförande	Number	Share of total	Share of sub-group
Board members	30	32%	
- of which no of board Chairs	17	18%	57%
- of which no of other members	13	14%	43%
Representatives of large owners	61	64%	
Other	4	4%	
	95		
Gender allocation			
Men	82	86%	
Women	13	14%	
	95		



more and more widely chosen to participate actively in nomination work following the Swedish model.

The gender allocation in nomination committees has been 86 per cent men and 14 per cent women (Table 3).

Owner representation in nomination committees

Table 4 shows the composition of the nomination committees regarding the owner category the members belong to or represent according to those criteria that govern the composition of nomination committees. The nomination committees from the point of view of numbers are dominated by representatives of institutional owners, who account for almost two thirds of all the members. Of the representatives for institutional owners a quarter of them are the board Chairs or CEOs of the institutions and three quarters are other executives in the institution, in most cases they hold corporate governance responsibility or corresponding positions.

Of the other categories major private owners in the company who are personally on the nomination committee account for 12 percentage points. A large number of them are also on the board of the company— in 19 cases as Chair and in 18 as other members. Other major owners are represented in the nomination committee by a specially appointed proxy. This group in total accounts for 10 per cent of all members, of whom one person is also a board member. Furthermore, in Table 3 five members are named as representatives for smaller shareholders.

Finally there is a relatively large group of members that have no appointed or otherwise known connection to the company owners. The majority of these are board members, in most cases board Chairs, but here there are also six persons in the “Other” category in table 3. The latter are, then, a small part of all the nomination committee members who are neither on the boards nor representatives of any particular owner or owner category. ◀

Table 3. Composition of the nomination committee

	Number	Share of total	Share of sub-group
Total number of members			
Of which board members	105	25%	
- <i>Styrelseordförande</i>	73	17%	70%
- <i>Annan ledamot</i>	32	8%	30%
Of which non-board members	320	75%	
- <i>Appointed representatives for major owners</i>	309	73%	97%
- <i>Appointed representatives for smaller owners</i>	5	1%	1,5%
- <i>Not representative for particular owner/owner group</i>	6	1%	1,5%
	425		
Expressed representation for major owners			
- of which Swedish owners	261	61%	84%
- of which foreign owners	48	11%	16%
	309		
Gender allocation			
Men	367	86%	
Women	58	14%	
	425		

Table 4. Owner representation in nomination committees

	Number	Share of total	Share of sub-group
Major private owners in the company (direct or indirect)	51	12%	
Institutional owners in the company	267	63%	
- of which institutions Chair/CEO	68	16%	25%
- of which ownership responsibility or other executiv	199	47%	75%
Proxy for other major owners in company	43	10%	
Appointed representatives for smaller shareholders	5	1%	
Persons with no appointed/known connection with company owners	59	14%	
	425	100%	

1) The term "appointed representative" means that when the nomination committee is appointed it is explicitly expressed that the person in question represents a certain owner or group of owners. However, this should not be interpreted that that person's task should be to give special preference to representing the interests of that owner in the work of the nomination committee. The idea should rather be that every member, independent of the way in which they were appointed has a duty to work for the good of the company and in the interests of all the owners. See also the comments on page 8.

CURRENT CORPORATE GOVERNANCE ISSUES

The Board's ambition is that this annual report, apart from a presentation of the work of the Board and the application of the Code during the past corporate governance year, shall provide a forum for discussion and exchange of ideas on current corporate governance issues both in Sweden and internationally. For this purpose the Board invites external authors to publish articles and contributions to debate which are considered to be of general interest in this area. Each author is responsible for the content of their contribution, and the opinions and ideas presented are not necessarily shared by the Board.

In this year's report there are three contributions of this kind:

- In the first article Rolf Skog, Honorary Professor of Company Law, Aarhus School Of Economics, Denmark, presents an overview of international corporate governance development over the last decade with special focus on the varying points of view on owner influence and election of boards which has developed from this. The discussion sets the Swedish model for nomination committees in interesting contrast to the corresponding phenomenon in, particularly, the Anglo Saxon corporate governance tradition.
- One question which has been much debated in recent years is the increasing activity of foreign institutions in the

AGM's of Swedish companies and the practical problems they meet when trying to use their right to vote at Swedish AGMs in a well-informed way. In the second article, Hege Sjo, owner responsible for Nordic investments in the British pensions' management institution Hermes Pensions Management, gives an informed illustration of a large international investor's way of working and the problems encountered when trying to exert ownership on the Swedish market. She also gives Swedish companies some interesting advice and tips for facilitating a constructive dialogue with this type of owner.

- In the third article, Matti Vuoria, CEO of the Finnish insurance company Varma as well as Chairman of the newly founded body The Finnish Securities Market Association which will administer the Finnish Code, presents his view of the need, and prospects, for a harmonisation of corporate governance in the Nordic countries. The background is the initiative taken in this direction by Matti Vuoria together with the Board Chair Hans Dalborg, which has led to an unconditional dialogue around these issues being started between the Nordic countries code authorities.

The Board would like to thank these authors for their valuable contributions to this year's Annual Report.



Corporate governance

– an international problem area with national features

The corporate governance discussion which has been going on around the world for several decades mainly concerns the different ways of handling conflict of interest between shareholders and company management. Conflicts are greatest in companies listed on the Stock Exchange, which by definition have many shareholders and often a widespread owner structure. This is why the corporate governance discussion was born in the United States, where large companies at an early stage sought financing from the share market.

The US corporate governance discussion eventually spread to Europe, where it has had, and has, great influence on the European discussion. Other contributions to the discussion have been the internationalisation of the capital markets and the strong position of US investors on these markets. The discussion in the US in recent years concerning the shareholders' rights at the AGM, especially in matters relating to nomination of board members and election of the board, reminds us, however, that the American system is based on quite a different ownership structure, a different view of the division of functions between company organs and a different regulation model from the European system and that the US system is not in all respects more shareholder-oriented than the European system.

Shareholder influence and board election in US listed companies

The ownership structure in large US listed companies was characterised, as early as the start of the 1900's by a broad spread. Shareholder collectives developed quickly into an almost atomistic mass of small owners with no influence over the company. The boards were appointed in practice by the executive management, who had the real power in the companies and in the best case used the board as a "sounding board" in the company. The auditors were appointed by the boards and did not function at all as the shareholder controlling body.

Reality put its mark on the regulations. In the United States, as in other countries, the basic rules in the area of corporate governance are to be found in company legislation. Company legislation quickly became a state matter. As early as the beginning of the 1900's states competed with

company legislation as a means of incorporating companies. The legislation in Delaware, the next smallest state, had then and still has the greatest power of attraction. This is where about half of all US listed companies are incorporated today.

The competitiveness in the area of company law has, according to many analysts worked against true shareholder influence. Through the fact that the power over where a company shall be incorporated de facto lies with the executive management, according to these analysts company legislation at state level has constantly developed in a direction that is more and more management friendly. Other analysts have another view of this but most agree that the state company law has not, in this case, supported an active shareholder role in listed companies.

It is certainly also true according to US company legislation that the AGM is the ultimate decision making body in the company but the distribution of roles between the AGM and the board is different from that in most European countries. A lot fewer issues need to be dealt with by the AGM in a US limited liability company than in a German, French or Swedish one.

Another difference relates to the decision making process of the AGM. Formally the starting point in US law is also that the decisions are taken at the AGM through a shareholder vote. In practice, however, the decisions are taken before the meeting, in a vote by collection of proxy statements which is initiated and controlled by the company. The AGM is often a forum for announcing the result of the vote by proxy.

Voting rights authorizations and votes by proxy are not unknown phenomena in European business but are employed to a much greater extent in US than in European companies and power over the vote by proxy mechanism lies with the company management in the US. "The proxy system is usually a species of absentee voting by mail for the slate of directors and the proposals suggested by the management", is a frequently recurring characteristic of statements in the area.

The power of the executive management over the proxy process and the predominant view that the board in all important matters should be a "sounding-board" for the management was early reflected in the composition of the company board. In more than half of the 500 largest US companies in 1970 at least half the board consisted of people that were

also part of the management and many of the other "outside" board members were in reality hand-picked by the CEO. It was a quite alien idea for most people that the board should represent a more pronounced shareholder interest.

In the light of some company scandals that attracted a great deal of attention, a discussion started in the middle of the 1970's about the composition, role and responsibility of boards. The discussion took up the monitoring function of the board versus the company management and led to a demand for a stronger and, a more impartial role for the board in relation to the company management. The demands were seized upon, not by the state legislator – company legislation at state level was unchanged in all important aspects – but by the "federal" New York Stock Exchange, that successively introduced more and more regulations of corporate governance character into its listing requirements. At the beginning of the 1960's the New York Stock Exchange had introduced a demand for at least two independent board members in newly-introduced companies. In the middle of the 1970's this demand was strengthened to at least three independent members and successively the view of what independent involves was clarified. Today the New York Stock Exchange demands that a majority of the board members are independent in that they have no "material relationship" with the company. It is also the task of the company to inform the stock market about which board members are considered to be independent and what this judgement is based on.

Parallel to the development towards an increased amount of, not only formally but actually, independent board members there developed among the boards the custom of setting up committees to deal with issues where there was a strong risk of conflict of interest between the shareholders and the executive management. In practice this has meant three types of committees, namely audit committees, remuneration committees and nomination committees. The New York Stock Exchange demands today that such committees shall exist in all listed companies and that they shall consist entirely of independent members.

The view of the composition, the role and work of the board in US listed companies is different today than it was a

couple of decades ago. In many companies the board is a real power factor and a counterbalance to the executive management, which probably also means that the interest of the shareholders are being taken care of in a better way. However, this is not the same as the shareholders being able to exert greater influence on the composition of the board.

Shareholding in US listed companies has been increasingly institutionalised during the most recent decades. Pension funds, insurance companies, mutual funds and similar institutions today hold shares representing just over two thirds of the total stock market value but these and other shareholders still have in practice no possibility to launch proxy statements and include their own candidates to the board before an AGM. Several attempts have been made during recent years, for example by The Securities and Exchange Commission (SEC), to break the power of the executive management and give the shareholders some access to the vote by proxy machinery, but so far these attempts have been in vain. They have been effectively stopped by company executives and others who have risen up to defend the existing system.



Shareholder influence and election of boards in European and particularly Swedish listed companies

The ownership structure in European listed companies is, with the exception of the conditions in Great Britain, typically much more concentrated than in US companies. In many European listed companies there is still a controlling shareholder or group of shareholders with an important stake in the company.

Neither is there any doubt that shareholders in European listed companies with the starting point in above all company law have much greater opportunities, directly via the AGM to influence decisions in the company, than is the case in the United States. The division of functions between the AGM and the board is, as was mentioned above, different in Europe, where several issues come up for decision at the AGM.

Company law in Europe also grants the shareholders a comparatively strong influence via the AGM. Certainly there are variations in these respects between the European countries but they can be expected to lessen when the newly passed EU Directive on shareholder rights has been implemented in the Member States in a few years time. The directive will ensure that AGMs are convened in good time and that documents concerning items on the agenda are made available in time for all shareholders, wherever they live, to be able to make well-founded decisions and give their votes in time, so that they can initiate issues and propose decisions at the AGM, ask questions and get answers and can easily participate in the decision-making of the AGM, through electronic voting. The directive indicates in general a different view of the role of the shareholders in European than in US companies.

With regard to the specific question about the shareholders' influence over the election of the board there are also, however, relatively great differences between the different European countries, something that is reflected in the EU Commission work in the area of corporate governance, where a proportionately great deal of decision-making is left to the Member States. In 2003 the EU Commission published an instruction on independent board members in which the

Member States were recommended to introduce rules for e.g. nomination committees with regard to, simply expressed, listed companies. The Commission, however, did not state in detail how these committees should be appointed or composed.

The Swedish corporate governance system fits rather well into the general characteristic of the European structure of ownership and division of functions between the AGM and the board, but offers in several respects even stronger shareholder rights than is the case in many other European countries. Every shareholder according to the Swedish Companies Act has the right to initiate a matter at the AGM, independent of whether he or she has only one share. Every owner also has the right to ask questions and get answers at the AGM as well as to participate in the decision-making of the AGM. The shareholders elect with a relative majority the board members and the shareholders can at any time, through a simple majority vote and without special reason, dismiss the entire or part of the board, something that is not a matter of course in all European countries.

The most obvious difference, however, concerns the nomination of candidates for the board. The Swedish Code of Corporate Governance prescribes, in common with what is the case in several other European codes, and in line with what according to stock exchange rules is done in the United States, which in the large listed companies there shall be a nomination committee that prepares the question of the board election. But whereas regulation in most of the other European countries, as is the case in US regulation, sees the nomination committee as a group within the board, the self-evident starting point of the Swedish Code is that the committee shall be a body anchored in the collective of shareholders, independent in relation to the board and the executive management. The question in Sweden concerns in what way the best support in the shareholder collective can be achieved.

In brief the Code prescribes that the shareholders at the AGM shall appoint those people that will comprise the nomination committee or state which criteria shall apply when they are appointed. The nomination committee shall have at least three members. The majority of members of the nomi-

nation committee shall not be board members, and neither the CEO nor any other person from the executive management shall be a member of the nomination committee. The board Chair and other members of the board shall not be the Chair of the nomination committee.

At least six months before the ordinary AGM the company shall announce the names of members of the nomination committee. If a member is a “representative” for a certain shareholder then the shareholder’s name shall be made public. If a member of the nomination committee is replaced this shall be made public and the corresponding information about the new member announced. The information should be posted on the company web-site, together with information about how the shareholders can submit proposals to the nomination committee.

The nomination committee should submit proposals for the Chair and the other board members and proposals for remuneration divided between the Chair, other members and possible remuneration for committee work.

To summarize, the Swedish corporate governance system is more developed with regard to direct shareholder influence in the company than is the case in many other European countries, and particularly compared to the United States. This does not mean that the Swedish system lacks room for improvement but it is a reminder that notwithstanding the fact that corporate governance is an international problem area, the discussion in each country must be carried on from the point of the individual reality. The solution to problems cannot always be found in other countries or other parts of the world. ◀

Rolf Skog

European Corporate Governance Forum

Voting

– an essential right sometimes difficult to exercise

The legal framework, banking infrastructure and companies' voting arrangements have not developed at the same pace as the globalisation of ownership. Cross-border voting still entails significant resources and costs for investors. At Hermes we vote at the shareholder meetings of 4,000 companies annually and observe several areas where improvements would enable shareholders to execute votes more easily. Regulation and practices in Sweden make the voting process more complicated than in many other markets, making the provision of information to shareholders on a timely basis even more important.

Increased voting activity

Hermes is a fund manager independent of any broader financial services group. We invest well over €100 billion on behalf of around 240 clients including pension funds, insurance companies, government entities and financial institutions, as well as charities and endowments. However, Hermes' largest client is the BT Pension Scheme (BTPS) who, as owner of Hermes, gives its investment management perspective a unique insight and close alignment to the needs of other long-term investors and especially pension funds.

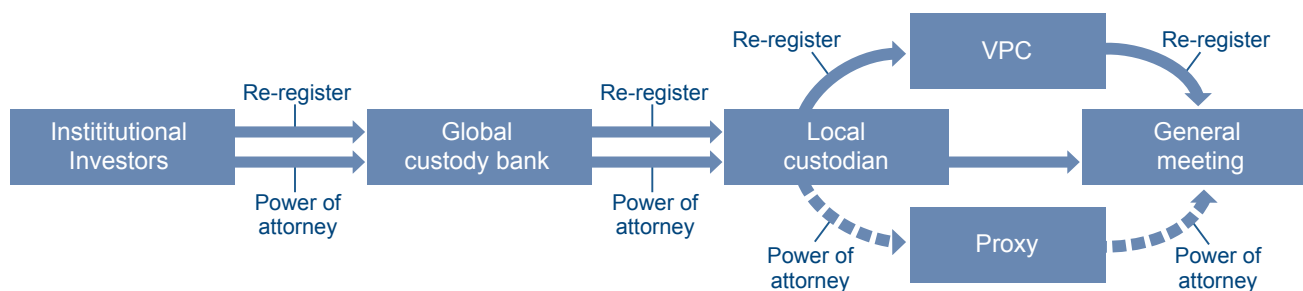
Shares in approximately 4,000 companies worldwide are voted wherever possible and Hermes have found appropriate solutions to the difficulties created in some jurisdictions by share blocking and other regulations. This ensures that investment performance is not negatively affected by our voting activities. Similarly we address the dilemmas caused

by stock-lending for investors who wish to vote responsibly and effectively. We put considerable effort into ensuring all our clients' votes are cast and all are counted.

Voting in Sweden

In Sweden shareholders wanting to vote at annual meetings must register by name and address in the share registry, VPC. This requirement is beneficial because the company and the market obtain accurate information about the beneficial owners' identity. On the other hand this transparency comes at a cost for foreign institutional shareholders who have to re-register their shares, as for private investors holding shares in nominee accounts.

Until 2005, according to Swedish company law a physical presence at general meetings was obligatory in order to vote. By appointing a representative (ombud), votes can however be cast on behalf of the beneficial owner. This practice, combined with the requirement to be registered by name in the VPC, requires shareholders to go through time consuming processes such as producing powers of attorney and certificates of secretary with the necessary formal notification. In addition, shares are in effect locked up and not available for trading for a period of approximately two days. The table indicates the steps in the proxy voting process and provides a typical time line. As shown, the time between companies being required to disclose all relevant material and the deadline for investors to vote can be very tight. In practice, the annual report may not be available until the



Graphic: Nordic Investor Services

deadline has passed. Fortunately this is seldom the situation anymore. A well informed and well substantiated vote does, however, require more time than shareholders have available on average to vote at Swedish companies.

Hermes' voting analysis

Each company and each item on the agenda requires detailed examination prior to voting. The first component of this research is a careful analysis of the company's annual report, meeting agenda, and any other publicly available information to identify particular issues of concern. This

includes consideration of all voting issues with particular attention to the board composition, the appropriateness of the remuneration proposals and share issue mandates. Our extensive database of company contact goes back over ten years and contains details of all communications with companies. Earlier contact and meetings is also key to the decision-making process. A range of other factors such as the views or assumptions of advisory agencies, brokerages, fund managers, news flow and elsewhere are then considered in arriving at our voting decisions.

We believe that a flexible 'comply or explain' approach to corporate governance guidelines is appropriate for most

Outline of the voting process

No. of days	Deadline	Actions
0	AGM	Voting instructions and papers couriered to representative
-5	Registration day VPC deadline to re-register = Company deadline to register to meeting	Registration Global custodian issues certificate of holdings to subcustodian Instruction from global custodian to confirm holdings Confirm and verify powers of attorney and certificates of secretary Re-registry of shares in VPC Shares blocked until VPC's registration day
-7	Sub-custodian deadline	Submit instructions through voting platform Global custodian bank produce certification of holdings
-10 to -15	Voting platform cut off	Analysis Identification of contentious or unclear issues Seek additional information from company and other sources Communicate with the company Communicate with other shareholders Decide whether to participate at meeting or vote by proxy Decide whether to recall lent shares
-14	Deadline to publish annual report	
-28 to -42	Notice of meeting	



companies. This implies that we do not apply absolute standards or requirements in respect of different proposals. However, such an approach requires significant resources. In many cases meeting agendas are relatively straightforward, while at some companies there are issues that give cause for considerable concern. In cases where we are minded to vote against management on the basis of the information we have, we will always discuss the issue directly with the company. The aim of this contact – which usually takes place by telephone – is to establish the facts and circumstances surrounding the issue and check our interpretation of the resolution. In addition we confer with other shareholders in various circumstances.

Where we continue to have concerns after our discussions with the company, we will encourage the company to modify its proposal so as to allow us to support the motion. This may involve a particular commitment or a modification to make it more shareholder friendly or indeed its withdrawal of the resolution. Where we believe that this is not going to happen, or where we have long-standing unresolved concerns about a particular company, we will vote against the company's proposal. In these instances we write a letter to the chairman of the board of directors explaining our position and encouraging further contact.

How can companies help investors improve voting quality?

The time-consuming voting procedure is primarily a result of the legal requirement for shareowners whose shares are held in nominee accounts to re-register with the VPC. Other parts of this voting chain can, however, be influenced by the company both to prolong the time given to investors to analyse material and to improve the quality of voting directly.

Issue annual report and all voting material well in advance

Interactions with the company, other shareholders and verification of information require time. As such, timely disclosure is the single most important step companies can take to ensure informed voting.

Streamline the voting process

By amending the articles of association companies can now facilitate proxy voting without personal attendance at meetings. Changes in company law have opened the way for shareholders to send voting instructions directly to the company. A few companies have taken this opportunity. Among these are Nordea, TeliaSonera, Swedish Match and Eniro. Eliminating one link in the voting chain between shareholders and the company would simplify the process. We believe that passing voting instructions directly to companies would be to their benefit as it would encourage a more direct dialogue with shareholders. This suggestion would not only benefit foreign institutions and their beneficiaries. Swedish institutional owners also need to vote at more meetings than they can practically attend. Sweden has a strong tradition of well attended general meetings and active participation by shareholders. We are convinced that facilitating proxy voting would not jeopardise attendance or the desire of investors to use general meetings as the principal forum to meet the company. On the contrary, our experience is that better access to information and easier voting procedures generate heightened interest in the company. This may in turn cause more investors to attend general meetings.

Understand institutional investors' and advisers' voting policies

Institutional investors are increasingly exercising their voting rights outside their home market as well as within it. Several rely on voting advisory services such as ISS, Glass Lewis and Nordic Investor Services for company analysis, ballots and exercise of votes. To help increase the level of informed voting companies should therefore:

- Include the relevant advisory services in their investor relations communications to enhance the analysts' understanding of Swedish and company specific issues;
- Understand how the meeting notice is "translated" into a "voteable" electronic ballot;
- Make efforts to understand the advisers' voting policies and be ready to communicate and explain specific circumstances.

Keep proxy voters informed

Investors voting by proxy forgo the opportunity to participate in useful debates in the meetings and to vote for resolutions that are only presented at the meeting. It is not unusual for several proposals to be put to the meeting and voted upon. We encourage companies to count votes on such resolutions and to include details of the discussion in the minutes of the meeting.

Final remarks

Levels of disclosure and timeliness of disclosure has improved significantly among most Swedish companies over the last year. The 2007 voting season has produced very few examples of information being generated too late for in-

vestors to meet voting deadlines. In particular, it is good to observe more detailed reports from nomination committees setting out their considerations regarding the board composition and the candidates' backgrounds. Sweden sets a good example in the newly implemented requirement for shareholder approval of remuneration policies. Furthermore we appreciate the improved reporting on corporate governance. In comparison with their peers in Europe, the larger Swedish companies have set the bar high in terms of disclosure, which provides a good basis for informed voting by investors. Further attention to timely disclosure, improving relations with foreign shareholders/voting agents as well as efforts streamlining the voting process will strengthen the positive momentum we are observing among Swedish companies. ◀

Hege Sjo,
Hermes Pensions Management Ltd.



The Harmonisation of Nordic Corporate Governance

All the Nordic countries have relatively recently introduced national Codes of Corporate Governance for companies listed on the Stock Exchange. The development and content of the Nordic codes is a reflection of international development and national deliberation over a long period. The present codes have been introduced in all countries during the last four years.

There are more companies than ever today that, through their activities, and also by virtue of their structure of ownership, can be deemed to be Nordic. This is particularly true of companies in Finland and Sweden, but the number of joint-owned companies involving Denmark and Sweden as well as Norway and Sweden has also increased. Icelandic investors have played a very active role in the Nordic share market in recent years.

It is a paradox that as economic integration has deepened, the development in legislation, for example in The Company Act, and within self-regulation, has moved in the opposite direction. Both Finland and Sweden have recently introduced new Company Acts that have replaced the joint Nordic laws from the 1970's.

Since the Nordic countries now have a common stock exchange and stock exchange list, it is time to consider and discuss the interest and pre-requisites for common guidelines of corporate governance within the Nordic Stock Exchange.

As I see it there is great and increasing interest within the Nordic business world to strive for common guidelines for listed company governance. There are a few genuinely global large companies in the Nordic countries, and they are adapting their corporate governance primarily to the American and British regulations. The content of the Nordic Codes is not a question of high priority for these companies. Yet common standards would be particularly important for small and medium-sized listed companies, not to mention the development of a united Nordic Stock Exchange market.

The purpose, area of application and content of the current Nordic codes are close to each other, even though there are also structural differences which can be seen to be important and which are partly of a principal nature.

The common starting point of the codes is that they are a complement to statutory regulations and aim for increased transparency in the proceedings of listed companies. All the Nordic codes are founded on the principle of "comply or explain".

The Nordic codes are a result of self-regulation in the business world and the codes have been approved by the business organisations. The Swedish Code is however a result of common preparation between a government commission and the business institutions.

The Swedish code differs from the other Nordic codes, in that it is only valid for the largest companies listed on the stock exchange, while the other codes shall be applied by all listed companies. The Swedish code is more detailed, far-reaching and formal compared to the other codes. The Swedish code also contains detailed instructions concerning AGMs which are not included in the other codes.

In Denmark the code deals with the company's relations towards other interested parties (stakeholders) than owners to a greater extent than in Finland and Sweden. The Norwegian code contains regulations concerning share series and share trading. These are not to be found in the other codes.

There are also other differences between the codes, regarding the appointment of nomination committees, board members' independence and remuneration for the operative management.

In Finland, The Confederation of Finnish Industry and Employers, the Helsinki Stock Exchange and the Central Chamber of Commerce established The Securities Market Association at the end of 2006. The purpose of the new association is to generally influence, through its activities, the securities market's interpretation praxis and its development, to own The Finnish Code of Corporate Governance, and to take part in the Nordic discussions on the possibility of creating joint Nordic guidelines for corporate governance based on the principle of self-regulation.

Together with The Swedish Corporate Governance Board, the Finnish Securities Market Association has invited representatives of Denmark's, Iceland's and Norway's corresponding code owners to a joint discussion on the possibilities of harmonisation of the Nordic codes of corporate governance. We have received positive answers to our invitations from those invited.

This is a good sign. 

Matti Vuoria

The Finnish Securities Market Association, Finland

Contact

If you have any questions or comments for The Board of Swedish Corporate Governance, please contact

Hans Dalborg (Chair)

Nordea
105 71 Stockholm
Sweden
Telephone +46 (0) 8-614 78 01
Email: hans.dalborg@nordea.com

Lars Otterbeck (Vice Chair)

Hakon Invest
Box 1508
171 29 Solna
Sweden
Telephone +46 (0) 70-510 00 36
Email: otterbeck@telia.com

Per Lekvall (Secretary)

Kollegiet för svensk bolagsstyrning
Box 160 50
103 21 Stockholm
Sweden
Telephone +46 (0) 8-506 126 06, +46 (0) 70-751 90 99
Email: per.lekvall@bolagsstyrningskollegiet.se

KOLLEGIET FÖR SVENSK BOLAGSSTYRNING

Box 16050 | 103 21 Stockholm
www.bolagsstyrningskollegiet.se

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