

**White Paper:
Challenges to Swedish
corporate governance
due to EU-level regulation**



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Foreword

From the creation of the European Economic Community, harmonisation of company law in the Member States has been an important measure in striving to achieve freedom of establishment and free movement within the Common Market. Originally, this project was pursued through efforts to ensure that natural and legal persons domiciled in one Member State were to be able to establish and run companies in another Member State without being subjected to discrimination based on nationality, and that any Member State company law provisions discriminating against legal subjects domiciled in another Member State were to be removed.

For freedom of establishment to become a reality, however, it was not enough to purge Member State legislation of directly discriminatory provisions. There were also major differences in company legislation amongst the Member States which, while not discriminatory, were nevertheless perceived as hindering corporate acquisitions and making the establishment of companies across national borders more difficult, thereby frustrating the concept of a common market. The Treaty of the European Union therefore set forth that the Commission would strive towards harmonising the company legislation.

When Sweden became a Member State in 1995, this endeavour had already come a long way. The adaptations of Member State laws to the dozen existing company law directives were complete, and thus much of the original goal of harmonising the most fundamental aspects of company law had been fulfilled. However, the Commission's work in the field of harmonising company legislation continued, and continues today, but with new harmonisation goals. While this work initially consisted of harmonising company law basics, such as rules on registration and capital protection, the focus of the Commission's work shifted to questions more specific to the organisation of the largest listed companies in the Member States: what we now call corporate governance.

And so, since the early 2000s, the focus of the Commission's work in the area of company law has been to improve corporate governance in European listed companies, with the stated aim to:

- 1) improve the functioning of the EU single market through increased harmonisation of corporate governance rules and practices within the Union;
- 2) strengthen the role of shareholders, particularly in listed companies; and
- 3) increase the competitiveness of European companies.

While these goals are admirable, the pursuit of them is by no means straightforward. Corporate governance, i.e., the system of rules, practices, and processes by which a company is directed and controlled, is today widely accepted as intrinsically connected not only with the structure of company law in a given jurisdiction, but also with the national and international markets' organisation, ownership structure, business culture and even social traditions at a national level.

This means that it is very difficult to talk about "best practices" to work towards in corporate governance, save for in general terms, (as shown for instance by the G20/OECD *Principles for Corporate Governance*). What constitutes "good corporate governance" is thus a question that needs to be placed in a specific (national) context. Second, as corporate governance is so tightly connected to extra-legal structures and paradigms, it also follows that changing a corporate governance system is not something that can be achieved purely through legal means, but requires that regulatory changes be carried out with knowledge, and respect, of the surrounding corporate governance landscape.

The Commission's work on harmonising corporate governance has perhaps not always been sensitive enough to the interconnectedness of the different parts of the corporate governance system and the inevitable national variations. At least, this has been a somewhat distinguishing feature in the Swedish experience as a recipient of the Commission's work, as is described in this white paper. Somewhat ironically in the light of

the stated goals of the Commission’s work, the greatest impact of the efforts to harmonise corporate governance regulation within the Union on Swedish corporate governance has been that it has *threatened* rather than strengthened the role of shareholders in the corporate governance of listed companies, which has also in turn risked *decreasing the competitiveness* of, if not Swedish companies directly, at least the Swedish stock market.

The purpose of this white paper, however, is not to criticise the work of the Commission, but to describe in a constructive and forward-looking way the challenges to the Swedish corporate governance system that it has posed. In many respects, these lessons could not possibly have been anticipated, since the Commission’s work in the area of corporate governance has in many ways been ground-breaking. But while it is clear that the Commission has learned from past mistakes, the main message in this report is that the EU corporate governance

agenda is still too ambitious or, more aptly described, *not ambitious enough* when it comes to understanding and respecting differences in corporate governance systems. Because while the message is in accordance with the now widespread agreement that there is no “one size fits all” model for corporate governance, that is not to say that there are some principles for corporate governance that are better or worse than others. Instead, the corporate governance landscape must be viewed in the same way as a geographical landscape, with multiple peaks (as well as valleys) and multiple paths to reach them.

This report was funded by the Swedish Corporate Governance Board and compiled by economist Per Lekvall. As with Per’s previous pioneering work on the Nordic corporate governance model, we hope that this white paper will also influence the international corporate governance debate and bring a more nuanced perspective to the EU corporate governance agenda. ◀

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1. Introduction

1.1 Background and purpose of the white paper

The first decades of the 21st century have seen intensive EU-level regulation activity within the fields of corporate law and corporate governance. The stated aims of this activity have been to

- i. improve the functioning of the EU single market through increased harmonisation of corporate governance rules and practices within the Union;
- ii. strengthen the role of shareholders, particularly in stock-exchange listed companies; and
- iii. increase the competitiveness of European companies.

To what extent these aims may have been achieved within a broader European context falls outside the scope of this white paper, but seen from a purely Swedish perspective they must be regarded as having largely failed. Overall, the measures taken cannot be seen as having brought much added value to Swedish corporate governance, while causing considerable problems in at least three crucial respects:

- *Firstly*, by flagrantly contravening Swedish company law and/or other Swedish governance rules and practices on several counts.
- *Secondly*, by adding significantly to the administrative burden, particularly that of listed companies, thereby compelling boards and senior management to devote considerable amounts of time and attention to bureaucratic matters rather than to business strategy and performance.
- *Thirdly*, by introducing a number of materially harmless but superfluous rules that only serve to increase the total amount of regulation without adding any significant value, thereby also over time undermining respect for more pertinent regulation.

The aim of this white paper is to elaborate on and substantiate these points and from there to propose an EU-level regulatory approach that would better serve its intended purpose without causing unnecessary problems in Member States. The paper will provide an overview of the main EU regulatory activities within the field,

starting around the turn of the century, then discuss in some detail how the implementation of several of these measures in the Swedish context has posed considerable problems and adversely affected the Swedish corporate governance model, and finally outline some main features of an alternative regulatory approach, more considerate of the multitude of corporate governance systems within the Union.

However, in order to put these discussions in their proper context, we will begin with a summary of the roots and rise of modern European corporate governance and of early efforts by the European Commission, (henceforth the Commission), to harmonise European corporate legislation prior to the last two decades.

1.2 The emergence of European corporate governance

1.2.1 An American legacy

Modern corporate governance traces its origin back to the mid-1970s when the U.S. Securities and Exchange Commission (SEC) brought legal proceedings against the “outside” directors of some companies for failing to see and take appropriate action against alleged misconduct of the executive management. In fact, the term “corporate governance” is said to have first appeared in a 1976 issue of the Federal Register, the official journal of the U.S. federal government.¹⁾

The SEC action sparked a lively debate on the accountability of directors towards the owners of the company they served, with demands being aired for a majority of independent directors on boards, the establishment of certain board committees, and shareholder participation in the election of directors. Yet, with the exception of some requirements on companies listed on the New York Stock Exchange (NYSE) to have an audit committee, at this stage regulatory action was confined to demands on publicly traded companies to disclose information about the independence of their directors and the existence of audit, nomination and remuneration committees.

¹⁾ Cheffins, B.R.: *The History of Corporate Governance*. ICGN Law Working Paper no. 184/2012. The initial paragraphs of this subsection draw heavily on this paper.

The late 1970s and early 1980s saw three crucial new developments in corporate governance thinking. One was the agency theory, based on the pioneering work by Jensen and Meckling in 1976²⁾ and Fama in 1980³⁾, which offered a coherent conceptual framework that was to form the main theoretical basis of corporate governance for decades ahead. The second was the increased role of takeovers as a means to discipline boards and managements to act in the interests of the shareholders in the absence of sufficient shareholder power to deal with high-handed boards in many US listed companies at the time due to their highly dispersed ownership structure. The third new development was the increased engagement of institutional investors in the governance of companies. On this foundation, the rest of the 1980s and 1990s saw a rapid increase in, typically mandatory, regulation dealing with the same aspects of corporate governance as in its early days, i.e. director independence, board committees and the empowerment of shareholders, but also with an increased focus on executive compensation. As there is no federal company law in the U.S., these regulatory efforts mainly took the form of SEC rules and stock exchange listing requirements.

1.2.2 Corporate governance comes to Europe

Up until the early 1990s, these developments were predominantly an American affair, with few repercussions in other parts of the world, including Europe. However, as a result of a number of high-profile corporate scandals in the UK around this time, a commission was set up under the chairmanship of Sir Adrian Cadbury with the remit to analyse the root causes of these events and to come up with proposals for remedial action. The commission's report, presented in December 1992 and widely known as the Cadbury Report, quickly caught on as a pioneering contribution to European corporate

governance and has since had a pivotal role for the dissemination of governance codes around the world. Its main contributions were not only to pick up certain key elements of American corporate governance and adapt them to European circumstances, but also to summarise its recommendations in a Code of Best Practice based on the *comply-or-explain* principle, a bold new notion within the field of corporate governance regulation, and to have this code incorporated in the listing requirements of the London Stock Exchange.

The Cadbury Report was followed by a number of reports dealing with various aspects of UK corporate governance, most prominently the Greenbury and Hampel reports, and in 1998 the three reports were amalgamated into the Combined Code of Corporate Governance, the first officially endorsed UK national code. Meanwhile, the concept of corporate governance codes based on the comply-or-explain principle rapidly spread around the world, (except to the U.S.), and by mid-2003 no less than 141 different codes in 35 countries had been published.⁴⁾ Also, several supranational organisations published various sets of guidelines and recommendations, most prominently perhaps, the pioneering OECD Principles of Corporate Governance from 1999.⁵⁾ ◀

²⁾ Jensen, M.C. and Meckling, W.H. (1976): *Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure*. J. of Financial Economics 3(4), 305-360.

³⁾ Fama, E.F. (1980): *Agency Problems and the Theory of the Firm*. J. of Political Economy 88 (2), 288-307.

⁴⁾ Cuervo-Cazurra, A. and Aguilera, R.V. (2004): *The Worldwide Diffusion of Codes of Good Governanc*. In Grandori, A., ed.: *Corporate Governance and the Firm Organization*. Oxford University Press 2004, 318-348.

⁵⁾ Later repeatedly updated, the most recent edition being *The G20/OECD Principles of Corporate Governance*, published in 2015 and endorsed by the G20 Leaders Summit of the same year. Other related OECD publications are the 2015 *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, and the 2004 *OECD Guidelines for Multinational Enterprises* (originally published in 1973).



2. Early efforts to harmonise European company law⁶⁾

2.1 The first decades

Although the Treaty of Rome had called upon the Commission to harmonise corporate law in the new community, it was not until 1968 that the first company law directive, on company registration, was adopted. Yet following this tardy start, in the subsequent two decades or so, twelve additional company law directive proposals were submitted by the Commission, all but three of which were adopted by the Council. Of those nine adopted proposals, five are focused on pure corporate law issues, (the 1st, 2nd, 3rd, 6th, and 12th directives), whereas the remaining four dealt with accounting, (the 4th and 7th directives), auditors, (the 8th directive), and the opening of branches in other Member States (11th directive).

However, the sole Commission initiative of primary corporate governance significance, the draft 5th company law directive on the organisation of public companies, the rights of shareholders to determine directors' remuneration, and employee co-determination, failed to obtain Council approval after lengthy negotiations, largely due to the difficulty of reconciling German and French governance principles with the Anglo-Saxon tradition of the new Member States UK and Ireland. For similar reasons, two other draft directives from this period never got off the ground, namely the 9th directive, on corporate groups, and the 10th directive, on cross-border mergers, (although the latter later resurfaced in the form of Directive 2005/56/EC).

Hence, at least from a purely corporate governance point of view, the outcome of these two decades of harmonisation work was quite meagre, and towards the end of the 1980s the Commission's efforts in this respect seemed to have more or less run out of steam. Instead, much of the energy of the 1990s and early 2000s was devoted to two partly related initiatives: a draft directive on takeovers and a crusade against dual-class shares in listed companies.

2.2 The Takeover Directive

The first of these initiatives traced its origin back to the mid-1970s, when the Commission presented a draft directive aimed at facilitating company takeovers in order to create more open and dynamic markets for corporate control. However, since takeover bids were at that time an almost unknown phenomenon on continental European markets, there was only scant interest in the idea among the majority of Member States and the idea was soon shelved. It then took until 1989 for the Commission to present its first directive proposal on this issue. This met, however, with heavy criticism and had to be fundamentally revised before being submitted to the European Council and Parliament in mid-2001 for "trialogue" negotiations and voting, where it was finally rejected due to German resistance in particular to its restrictive stance on defensive measures by the target company. In spite of this setback, the Commission continued its efforts, and in April 2004, more than 30 years after the matter was first brought up, Directive 2004/25/EC was at last adopted in a heavily watered-down version that was widely considered to have left nobody happy.

2.3 Proposed ban on dual-class shares

Already before the turn of the century, the use of dual-class shares had from time to time been the subject of debate. Under the mantra "one share one vote", especially US- and UK-based institutional investors, who were accustomed to markets with predominantly dispersed ownership of listed companies, called the practice, more prevalent on continental European markets, increasingly into question for its alleged "shareholder democracy" deficit and lack of proportionality between capital provided and strength of voice in the governance of the company. To some extent, it was also part of the controversy over the Takeover Directive, as dual-class shares were seen by some Member States as one means of defence against hostile takeovers.

⁶⁾ This section rests heavily on Skog, R. (2020): *EU och bolagsrätten i medlemsstaterna* (in English: *EU and Corporate Law in the Member States*). Vänbok till Anders Lagerstedt – Studier i associationsrätt och förmögenhetsrätt, JURE, Stockholm (available only in Swedish); and on Skog, R. (2004): *The Takeover Directive, the "Breakthrough" Rule and the Swedish System of Dual Class Common Stock*. *European Business Law Review* (15), 6/2004.

To meet mounting pressure for an EU-wide ban on dual-class share schemes, when the new European Commission of 2004 took office its Commissioner for Internal Market, Charlie McCreevy, announced his intention to launch some sort of regulatory intervention aimed at curbing the practice. This triggered a heated debate in which a number of Member States, especially Sweden and Finland, adamantly opposed any such action. The strong opposition to the idea had its roots in a long tradition of regarding share classes with different voting rights as a legitimate way to allow major shareholders to largely control their companies, (a cornerstone of Nordic corporate governance), and more recently reinforced by viewing the practice as a means to encourage young entrepreneurial companies to go public at an earlier stage of development than would otherwise generally be the case. Proponents of the system further argued that “freedom of contract” is a hallmark of an open market economy, and that investors who disliked the system always had the option of refraining from investing in companies that used it.

To break the deadlock, the Commission ordered a pan-European study to provide a more solid empirical basis for its further considerations. The report, presented in June 2007⁷⁾, showed that a wide variety of control-enhancing mechanisms other than dual-class shares, e.g. pyramid and cross-ownership structures, were prevalent all over Europe, and that there was no robust evidence indicating that such mechanisms would adversely affect company value. Consequently, Commissioner McCreevy concluded that “[t]here is no economic evidence of a causal link between deviations from the so-called ‘proportionality principle’ and the economic performance of companies”, and the case was finally dropped.

A key lesson to be learned from this case is the vital importance of EU-level regulatory measures being founded on solid empirical evidence, obtained through objective and methodologically well-designed studies, rather than on eloquent and loud voices in the open debate or on studies designed to produce pre-determined results. We will have reason to return to this matter in a subsequent section. ◀

⁷⁾ *Proportionality Between Ownership and Control in EU Listed Companies*. External Study Commissioned by the European Commission to ISS in collaboration with Shearman & Sterling LLP, and ECGI, Brussels 2007.

3. A new EU regulation agenda⁸⁾

3.1 The 2003 Action Plan

Before the turn of the century the Commission had shown only scant interest in the emergence of modern corporate governance. However, around this time, a new realisation had begun to take hold, that corporate governance might present an opportunity to revive and renew the Commission's harmonisation agenda regarding governance rules and practices, which had until then largely failed as we have just seen. Hence, in the spring of 2001, the Commission ordered two fact-finding studies that would prove momentous for its continued work on these matters: the law firm Weil, Gotshal & Manges was commissioned to carry out a comparative study of existing corporate governance codes among the EU Member States; and a High Level Group of Company Law Experts, generally known as the Winter Group, was given the remit to provide advice regarding key priorities for modernising company law in the EU.

After a comprehensive review of the governance frameworks of EU Member States, which showed considerable variation in terms of both legal and code-based regulation, the Weil, Gotshal & Manges study concluded that “there is little indication that code variation poses an impediment to the formation of a single European equity market” and that therefore “the European Commission need not expend energy on the development of a code applicable to companies in the European Union”.⁹⁾ And among a multitude of findings pertaining to a broad range of company law and corporate governance issues, the Winter Group concluded that, rather than striving for a common European code, the Commission should call on all EU Member States to draw up a national corporate governance code, consistent with their respective legal and other specific preconditions, according to which companies subject to their jurisdiction should report on a comply-or-explain basis.¹⁰⁾

Largely based on the findings of those reports, the Commission published its *Action Plan COM (2003) 284: Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward* in May 2003, outlining an ambitious agenda of engagement in the continued development of corporate governance in the EU. A key element of the plan was to refrain from trying to develop a common European corporate governance code, due to the wide variety of legal frameworks within the union, but instead recommend each Member State to establish a designated national code. In the plan, the Commission also announced its intention to pursue an agenda of successive harmonisation of certain key aspects of corporate governance such as transparency, shareholders' rights, board composition and directors' remuneration and duties. The implementation of this agenda through a stream of Commission initiatives in different legal forms was to largely forge European corporate governance in the decades to come.

The ensuing development may be divided into two main phases, with a short period of lower activity level in between. The first ran from 2004 until roughly 2008 and the second from 2009 onwards. Below follows an outline of the most important elements of this course of action. It does not aim to present anything close to a comprehensive account of EU regulatory interventions within the fields of company law, financial markets and corporate governance during this period, but merely to convey an overall picture of the stream of EU legislative action that Swedish corporate governance faced at this time and to highlight some of the most consequential Commission initiatives in this context.

3.2 The first phase: 2004–2008

Once its new plan was established, the Commission quickly went to action. In a first wave lasting from 2004 until around 2007-08, most of the issues raised in the

⁸⁾ This and the following subsection focus on regulatory actions pertaining to (mainly listed) companies in general, whereas regulation directed specifically towards the financial services sector is dealt with only to the extent it has bearing upon corporate governance in a broader context.

⁹⁾ Weil, Gotshal & Manges (2002): *Comparative Study of Corporate Governance Codes Relevant to the European Union and Its Member States, Final Report & Annexes I-III*, pp. 6-7.

¹⁰⁾ Report of the High-Level Group of Company Law Experts on *A Modern Regulatory Framework for Company Law in Europe*. Brussels, 4 November 2002, p 72.

plan were systematically dealt with. To begin with, as we have already seen, in May 2004 the Takeover Directive (2004/25/EC) was finally adopted after a long and heated debate.

This was followed by two important Recommendations directly derived from the Action Plan. The first, *Commission Recommendation 2004/913/EC, fostering an appropriate regime for the remuneration of directors of listed companies*, was adopted in December 2004. The second, in February 2005, *Commission Recommendation 2005/162/EC on the role of non-executive directors and on the committees of the board*, recommended that a significant proportion of the directors be independent of the company and its senior management and of major shareholders; separation of the positions of Chair and CEO in unitary boards; and the establishment of audit, remuneration and nomination committees in boards. Although formally issued as non-binding recommendations, both have had profound implications for the design of remuneration systems, as well as the composition and work organisation of boards of European listed companies.

Also in December 2004, the *Transparency Directive 2004/109/EC*¹¹⁾ was adopted, revising the earlier Directive 2001/34/EC, most importantly by requiring the directors' signatures on the annual report to be preceded by a "certification statement" to the effect that to the best of their knowledge the financial statements and the management report were prepared according to applicable standards and conveyed a true and fair view of the company's financial position and performance. It also introduced additional thresholds for the notification of changes of major voting rights, including lowering the initial threshold triggering the obligation of such notification to five per cent. (This directive was later amended by *Directive 2013/50/EU*, involving certain alleviations for smaller companies.)

In June 2006 the new *Accounting Directive 2006/46/EC* was adopted, amending the 4th and 7th Company Law directives from 1978 and 1983 respec-

tively, mainly to the effect of requiring listed companies to publish annually a corporate governance statement disclosing *inter alia* which corporate governance code, if any, the company applies; any deviations made from this code and the reasons for doing so; and a description of the main features of the company's internal control and risk management systems in relation to the financial reporting system. It further required companies to disclose certain information about significant off-balance sheet arrangements and related-party transactions of material significance.

In July 2007 the *Directive (2007/36/EC) on the exercise of rights of shareholders in listed companies*, generally known as the Shareholder Rights Directive I (SRD I), was adopted. Its overall purpose was to encourage shareholders to engage in the long-term governance of the company, mainly by facilitating an active and informed participation in general meetings.

After this initial wave of regulation activity, through which the Commission realised major parts of the agenda of its 2003 Action Plan, it was generally thought that a phase of less fervent activity would follow. For a year or so this also appeared to be the case, as few initiatives of great corporate governance significance were taken from mid-2007 until the end of 2008, (with the possible exception of the *Commission Recommendation 2008/473/EC concerning the limitation of the civil liability of statutory auditors and audit firms*).

However, during this period, the global financial crisis broke out and grew, with inadequate corporate governance in the financial sector widely seen as a significant contributory cause of the problems. The Commission soon saw the potential in this situation for an alleged need for more stringent regulation, not only within the financial sector, but increasingly also among listed companies in general. Hence, at the beginning of 2009, a new phase of EU-level regulation was initiated, even more frantic and far-reaching than the preceding one.

¹¹⁾ Strictly speaking this directive does not belong to the sequence of EU company law directives but had its origin in the Commission's ambition to harmonise the rules on the European securities markets.

3.3 The second phase: from 2009 onwards

Unfit remuneration systems were held up as one of the fatal flaws of corporate governance behind the crisis. Thus, the Commission began by issuing two recommendations on remuneration policies in April 2009, one directed specifically towards the financial services sector and the other to listed companies in general: *Recommendation 2009/384/EC* on remuneration policies in the financial services sector and *Recommendation 2009/385/EC*, amending the two aforementioned recommendations of 2004 and 2005 as regards the remuneration of directors of listed companies in general. The stated aim of these regulatory acts was to counteract the harmful effects of inadequately designed variable and share-based remuneration, which allegedly underlay much of the short-term and excessive risk-taking behaviour that the Commission claimed to be a contributing cause of the financial crisis. Hence a range of measures aimed to mitigate such effects were introduced, including caps on variable pay, variable components being strictly based on predetermined and measurable criteria, so-called claw-back clauses, and deferred vesting of share-based remuneration.

Another perceived weakness of crisis corporate governance highlighted by the Commission was a lack of shareholders with a long-term view on their investment and active engagement in the governance of the company. This, in turn, was seen as a crucial cause underlying a mounting pressure on boards and managements to deliver short-term profits rather than long-term sustainable prosperity for their companies. To address this issue, the Commission presented a new *Action Plan COM(2012)740* in December 2012, outlining a roadmap towards *a modern legal framework for more engaged shareholders and sustainable companies*. It comprised three key lines of action: enhancing the transparency of companies regarding their corporate governance practices; engaging shareholders through increased power to oversee remuneration policies and related-party transactions; and simplifying cross-border operations, particularly for SME-type companies.

The years that followed saw major parts of the reform programme outlined in this Action Plan brought to fruition through a series of initiatives. A first step was to issue a consultation *Green Paper on Long-term Financing of the European Economy COM(2013)150*, followed in 2014 by a Commission Communication on the same topic, *COM(2014)168*, outlining a series of actions aimed at mobilising private and public sources of long-term financing, developing capital markets and improving the access to financing, particularly for SMEs. Although these acts were primarily directed towards the financial sector, the proposed actions would also prove to have significant repercussions for other types of companies.

In June 2013, the Commission then presented a new *Accounting Directive 2013/34/EU*, finally repealing the 4th and 7th Company Law Directives and amending the aforementioned Directive 2006/46/EC. The new directive introduced a largely novel rulebook for the financial reporting of singular companies as well as the consolidated reporting of groups; supplied new definitions of companies of different size categories; and introduced the concept of “public-interest entities” (PIE) that would play a crucial role in much of the forthcoming EU legislation. It also introduced the Management Report, a complement to the annual financial reporting, obliging companies to submit a review in more qualitative terms of their performance as well as the principal risks they face, and which was to include the Corporate Governance Statement introduced by the new *Accounting Directive 2006/46/EC*.

In October the same year, the new *Transparency Directive 2013/50/EU* was adopted introducing certain amendments to the Transparency Directive of 2004, of which the most important from a corporate governance point of view was the abolishment of the obligation of listed companies to issue quarterly reports.

2014 was to become a particularly eventful year in terms of EU corporate governance regulation. In April, the Commission issued a *Recommendation on the quality of corporate governance reporting (‘comply or explain’): 2014/208/EU*. The background to this was a mounting criticism of explanations of non-compliance

with code provisions for being of little information value, arguably caused by a trend towards increased “legalisation” of corporate governance reporting that in turn entailed increasingly standardised explanations that were largely devoid of substantive information. The main thrust of the Recommendation was therefore to specify in more detail the structure and substance of explanations of departures from code provisions, to make them meaningful to the market.

The same month also saw the adoption of the comprehensive *Audit Reform Package*, made up of two separate legal acts: *Directive 2014/56/EU* on statutory audits, pertaining to all companies and amending the aforementioned *Directive 2006/43/EC*, and *Regulation (EU) No 537/2014* on specific requirements regarding statutory audit of public-interest entities. Largely based on perceived weaknesses of the audit function unveiled by the financial crisis, the Regulation part of the package in particular entailed far-reaching changes regarding the auditing of PIEs and for the auditing profession as a whole.

Finally, in 2014, another comprehensive reform package was adopted: *Directive 2014/95/EU regarding disclosure of non-financial and diversity information of larger companies and groups*, generally referred to as the Non-Financial Reporting Directive (NFRD). In June 2017, this directive was supplemented by a new instrument in the Commission’s corporate governance regulatory arsenal, namely non-binding guidelines for the implementation of a directive (in this case *Communication 2017/C 215/01*). This is a kind of regulatory act that the Commission may issue on its own account under certain conditions, without having to go through cumbersome negotiations with the elected politicians of the Parliament and the Council. Two years later, in July 2019, these guidelines were further complemented by a Supplement on reporting climate-related information: *COM(2109) 4490 final*.

The period 2016-17 saw a relatively modest level of EU regulation activity within the field of corporate governance. This notwithstanding, in February 2015, the Commission published a *Green Paper SWD(2015)13 final*,

analysing the need for a European Capital Markets Union (CMU) and inviting interested parties to offer their input to this end. In September the same year, its *Action Plan on Building a Capital Markets Union: COM(2015) 468 final* was presented, outlining a series of initiatives aimed, among other things, at channelling private and public investments to SMEs and infrastructure projects in particular; facilitating cross-border investment; and improving the functionality of the European capital market.

Then, in May 2017, the second *Shareholders’ Rights Directive 2017/828/EU*, also known as SRD II, amending the SRD I of 2007, was adopted. Its overall aims were to strengthen the position of institutional investors in European listed companies and to encourage long-term shareholder engagement. Measures to achieve this included: helping companies to identify their shareholders by streamlining the transmission of information through the chain of intermediaries between the company and its shareholders; facilitating the exercise of shareholder rights at the General Meeting; increasing the transparency of asset managers and proxy advisors; and strengthening shareholders’ right to “have a say” on directors’ remuneration and related-party transactions, including the introduction of a mandatory remuneration report to be voted on at the Annual General Meeting.

In March 2018, the Commission published another crucial action plan: *Action Plan on Financing Sustainable Growth (COM(2018)97 final)*, outlining a comprehensive program in ten “Actions” aimed at re-orienting capital flows towards sustainable investments; managing financial risks related to environmental and social issues; and fostering transparency and long-termism in financial and economic activity.

The years 2018-19 also saw further implementation of acts regarding legislation within the corporate governance area: In September 2018, the (non-legislative) *Implementing Regulation (EU) 2018/1212* was published, laying down minimum requirements for implementing the SRD I with regard to shareholder identification, the transmission of information between the company and the shareholders, and the facilitation



of the exercise of shareholders' rights; in June 2019, the aforementioned supplement regarding climate-change information was added to the 2017 Guidelines on non-financial reporting; and in July the same year, *Draft guidelines on the standardised presentation of the remuneration report under SRD II* were presented.

Finally, this year, the Commission in December issued a *Communication on a European Green Deal: COM(2019) 640 final*, outlining a set of policy initiatives with the overarching aim of making Europe climate neutral by 2050. Although it spans a much broader scope of societal issues than corporate governance, it will also have far-reaching repercussions in this area.

Building on the ideas put forth in this Green Deal and the 2018 Action Plan, 2020 was to be a particularly active year, with a range of new initiatives from the Commission: in January, a Roadmap for a revision of the NFRD was launched with the aim of proposing a new regulation in the first quarter of 2021; in April, a consultation was launched with regard to a renewal of the Sustainable Finance Strategy; and in July, a Roadmap and an Inception Impact Assessment were launched with a view to initiating a legislative intervention pertaining to what was referred to as "Sustainable Corporate Governance". This latter initiative was largely based on a comprehensive study, commissioned by the Commission to the audit firm EY, which met with heavy criticism during the ensuing feedback period from a large number of commentators from different backgrounds and was widely dismissed as unfit for purpose as an evidence basis for EU-level regulation. Nonetheless, only weeks after this feedback period expired, the Commission launched a formal consultation on the same basis, which is due to be followed by a proposed directive in the second quarter of 2021. 

4. EU regulatory actions at odds with Swedish circumstances

Overall, the nearly two decades of intensive EU regulation activity outlined above must be regarded as having posed considerable challenges to Swedish corporate governance without adding much of significant value. Many of the Commission's interventions concerned governance problems that were not present within the Swedish corporate governance system, and where they were of real relevance in the Swedish context, nearly all of them had already been addressed through a combination of legal revisions and self-regulatory advancements well before the launch of the Commission's harmonisation agenda. Swedish Company Law underwent a thorough review from around 1990 until 2005, during which many of the principles of modern corporate governance were incorporated, and the self-regulation system of the Swedish business sector has a long tradition of swiftly adopting new trends and turning them into generally accepted practice. Hence many of the areas of the EU regulatory agenda from 2004 onwards had already been dealt with in the Swedish governance framework.

As a consequence, Swedish regulators, (lawmakers and self-regulation bodies), had to revise much of the existing regulation in order to adapt it to new EU requirements in ways that were in many cases not compatible with Swedish judicial traditions and general practice. A common cause of such a mismatch is that, from the outset, the EU regulatory agenda has been largely based on problems emanating from the Anglo-American governance framework. The reasons for this are unclear but may have to do with the fact that modern corporate governance first emerged and matured in these jurisdictions, in combination with the dominance of UK and US institutional investors in the international capital market. At any rate, the consequence has been that, to a considerable extent, provisions imposed through EU regulation have been a poor fit for, and occasionally even inherently contradictory to, Swedish governance

principles and practices. The following section will be devoted to a review of some significant examples of such difficulties.

The discussion will apply strictly to Swedish circumstances. True, as shown by a pan-Nordic study some years ago¹²⁾, the social, judicial and institutional circumstances in the four major Nordic countries are similar enough to warrant seeing their governance frameworks as a common corporate governance model. It is therefore reasonable to assume that the challenges imposed on Sweden have often also been experienced in other Nordic countries.¹³⁾ In fact they may in many cases have even broader European implications, since the corporate governance frameworks in most EU jurisdictions also differ significantly from the Anglo-American model.¹⁴⁾ Strictly speaking, this model in its fully-fledged form applies solely to Ireland among the post-Brexit EU Member States. Notwithstanding, in order to avoid any risks of misrepresentation, the discussion that follows makes only occasional reference to circumstances outside the Swedish jurisdiction.

Before elaborating further on these issues, a brief review of some significant differences between Swedish and Anglo-American corporate governance is appropriate.

4.1 Key differences between Anglo-American and Swedish governance cultures

The single most distinguishing feature of the Swedish governance system is its strict owner-orientation. This is based on a high degree of ownership concentration among Swedish listed companies in combination with a generally favourable view of major owners taking an active role in the governance of their companies. In fact, as shown in the aforementioned study of Nordic corporate governance, approximately two thirds of all companies listed on a regulated market in Sweden had at that time at least one shareholder controlling more than

¹²⁾ Lekvall, P., ed.: *The Nordic Corporate Governance Model*. SNS Förlag, Stockholm 2014.

¹³⁾ For a discussion of such problems in a Nordic perspective see Lau Hansen, J.: *Udfordringerne fra EU-retten till den nordiske ledelsesmodellen* (Eng. *Challenges to the Nordic governance model due to EU legislation*). Nordisk Tidsskrift for Selskabsret Nr. 4, 2019 (available only in Danish).

¹⁴⁾ For a review of the impact of EU regulation in a broader European perspective, see Hopt, K. J.: *Corporate Governance in Europe. A Critical Review of the European Commission's Initiatives on Corporate Law and Corporate Governance*. NYU J. of Law & Business, Volume 12, Issue 1 (Fall 2015).

20 per cent of the votes. By comparison, the corresponding share at the London Stock Exchange Main Market was about one fourth. There is no reason to believe that these numbers are significantly different today.

The power of major shareholders in the Swedish system is further underpinned by a strictly hierarchical governance structure, in which the General Meeting has almost unlimited powers to decide on any company affairs, including to issue instructions to the Board about how to run the company, (a power, however, which is rarely used in listed companies), and the ability to dismiss the entire Board at any time without stated cause. Furthermore, the (always unitary) Board is strictly subordinate to the General Meeting and typically seen as the owners' instrument for running the company on their behalf, and the (one-person) Chief Executive Officer, (henceforth CEO), is in turn subordinate to the board and subject to dismissal without notice at the board's discretion.

The board is mostly entirely non-executive, (no more than one member of the executive management may be a board director, an option used by less than 40 per cent of Swedish listed companies, generally by including the CEO on the Board), and the separation of the roles of Chair and CEO is mandatory by law for listed companies. In practice, this means that a coherent shareholder majority at the general meeting can effectively control the company. The possibility to form such majorities is further facilitated through the use of dual-class shares, an option used by about half of the companies listed on a regulated market.

The flip side of this strong power of controlling owners is a well-developed and generally effective system of shareholder minority protection. This system is made up of an intricate set of provisions: from a strongly worded – and generally respected – “general clause” in the Companies Act, effectively banning any governance body from taking any action likely to favour some shareholder(s) at the expense of the company or other shareholders; via extensive individual shareholder rights and qualified majority requirements for a range of General Meeting

decisions; to strict transparency and shareholder approval requirements for related-party transactions. Although the system is certainly far from flawless and in recurrent need of further tightening to cope with innovative challenges, as a whole it appears to have been quite effective in restraining controlling owners from reaping undue private benefits from their companies.¹⁵⁾

In contrast to this, the US/UK framework is characterised by generally highly dispersed ownership structures of listed companies. Often, no shareholder controls more than 5-10 per cent of the votes which, especially in combination with rules limiting the scope for shareholders to exercise their ownership rights “in concert”, generally entails weak shareholder power. Instead, the overall responsibility for the company has to be assumed by the Board, which is made up of a mix of executive and non-executive directors and where the positions of Chair and CEO are not infrequently, particularly in the US, held by the same individual. This, in turn, entails an inherent conflict of interest situation on the board that in fact makes up a defining precondition for some of the key principles of Anglo-American corporate governance, such as the requirement for independence of directors, board committees, and increased shareholder influence on the remuneration of board and management.

In short, whereas in the Swedish system the shareholders see themselves as owners of the company and employ the Board to manage it on their behalf, in the Anglo-American system the Board is in charge of the company, with the shareholders seen rather as investors who enter and exit the company as they assess its performance prospects from time to time. It should come as no surprise that a regulation agenda that is largely based on the latter system does not always fit well into the former.

Concluding this subsection, it should be underlined that the Swedish system is in no way to be seen as a panacea for corporate governance in other jurisdictions. It is designed to fit into the Swedish institutional and cultural framework and appears to have served Swedish companies well¹⁶⁾, but there is no evidence that it would perform equally well in other judicial contexts.

¹⁵⁾ See Nenova, T.: *The Value of Corporate Voting Rights and Control: A Cross-country Analysis*. J. of Financial Economics 68 (2003), 325-351; or Gilson, R. J.: *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*. Harvard Law Review, Vol. 119, (2005), 1641 ff.

¹⁶⁾ See Lekvall (2014) op.cit. pp. 14-15 and 28-29.

4.2 Major areas of judicial inconsistency

In this section we will highlight a number of cases of EU regulation that have negatively affected Swedish corporate governance and/or have required specific counteractive measures to mitigate such consequences. The discussion will firstly focus on the three key areas of early corporate governance regulation mentioned previously, i.e. independence of directors, board committees, and the remuneration of board and management, and then proceed by presenting some further instances of EU intervention more or less at odds with Swedish circumstances.

4.2.1 Independent directors

As we have seen, the notion that some directors ought to be independent of the company and its management was a defining aspect of modern corporate governance from its very beginning, (cf. p. 3). The background to this is the mixed composition of US boards at the time, typically comprising a blend of executive and non-executive directors, not infrequently with the first category in the majority. This caused a conflict-of-interest problem on boards, whereby a significant proportion – or even majority – of the directors could have a self-interest that was poorly aligned with that of the company and its shareholders. To cope with this problem, requirements were introduced for a certain proportion of the board to be made up of “outside” directors without any relationship to the company and its management that might risk compromising their integrity. No mention was made at this time of independence in relation to the owners of the company; in fact, when corporate governance provisions were incorporated in the NYSE listing requirements in the 1990s it was explicitly stated that even owning a significant amount of stock in the company would not prevent a director from being deemed independent.¹⁷⁾

The same view was adopted by the Cadbury Committee when bringing the corporate governance concept over to Europe. Hence, a key recommendation of its Code of Best Practice was that a majority of the (at least three) non-executive directors of the board be independ-

ent in relation to the company without any mention of independence vis-à-vis its shareholders. However, when the UK Combined Code was first launched in 2006, “representing a significant shareholder” was included among the set of criteria to be considered when defining a director as independent or not. This change may have been well motivated in the UK market, with its generally dispersed ownership of listed companies and subsequent scepticism towards strong shareholders, but makes little sense in many other European jurisdictions. Yet the same approach was broadly applied among the many new corporate governance codes established around the world in the subsequent years, whether or not the ownership structure in these markets resembled that of the UK or not. Hence, independence in relation to major shareholders, typically defined as shareholders controlling more than ten per cent of the votes of the company, became an international standard for director independence.

Against this background, it may be understandable that one of the Commission’s first initiatives as it began to implement its corporate governance agenda, the January 2005 Recommendation, contained requirements regarding director independence, essentially copied from the Combined Code concept, as a key element. It is nevertheless remarkable that this was done ostensibly without regard for the wide variety of corporate governance systems within the EU, in many of which controlling ownership of listed companies is more the rule than the exception. And concerning Sweden, it is outright *anathema* to its emphasis on the right – and duty – of major owners to govern and take long-term responsibility for their company.

It is clear that at least a majority of the directors should stand free from any personal dependence towards the company and its management in order to be able to discharge their duties with unfettered integrity. However, this condition is typically fulfilled to excess in Swedish boards, due to their predominantly non-executive composition. Independence towards major owners, in contrast, is inherently contradictory to an expectation

¹⁷⁾ This still (spring 2021) remains true, see NYSE Listing Requirements, Section 303A.02.



that such owners engage actively in the governance of their companies, a role that must include the right to choose directors of their trust and liking, and also for themselves to take seat on the board in person.

Against this backdrop, the independence clause in the Commission's 2005 Recommendation caused considerable concern for the Swedish "Code Group", which at the time was working to develop the country's first national corporate governance code. The solution was to make a distinction between on the one hand independence towards the company and its senior management and on the other hand independence towards major owners, and to require a majority of the directors to be independent in the first sense but only two in the second.¹⁸⁾ In fact, a provision of this purport had been part of the listing requirements of the Stockholm Stock Exchange since the mid-1990s, generally seen as a measure to further strengthen shareholder minority protection in Swedish corporate governance.

4.2.2 Board committees

Another key element of early corporate governance was the notion of board committees to deal with matters involving inherent conflicts of interest in the typical US board of the time, due to its mix of executive and non-executive directors. Issues considered particularly at risk of such conflicts were the statutory audit of the company, the remuneration of its executives and the nomination of candidates for board positions. Hence the three "classic" board committee categories: the Audit, Remuneration, and Nomination committees.

Since then, those committees have become part and parcel of statutory and/or code regulation all over the world, and their presence in at least major listed companies is widely seen as a key criterion of high-quality corporate governance. And certainly, for the reasons just outlined, they are well motivated in jurisdictions where mixed boards of the Anglo-American type are standard. However, in jurisdictions where this is not generally the case, as in the supervisory board of two-tier systems and the Nordic predominantly non-executive board,

their relevance is less obvious. It should be noted that the division of a board into subcommittees also comes at a price in terms of the risk of ending up with "A and B teams" in the board – and thus, in practice, inequality of accountability among the directors – as well as of increased internal bureaucracy, both potentially damaging for board efficiency, especially in the case of smaller boards.

Yet in boards of, say, 7-8 or more members, the establishment of committees for dealing with certain sub-sets of the board's total range of duties may be an efficient way of organising its work. Not least, this is often the case when it comes to audit committees, typically set up to deal with matters of financial reporting, internal control and risk management, areas for which the workload of boards has multiplied over the last 10-15 years. Especially in larger boards, it is therefore generally more efficient to have a subset of the directors go into detail about such matters in order to prepare and propose the board's decisions, rather than having the entire board get bogged down in this work. Likewise, it is generally impractical to have the whole board engaged in negotiations with executives regarding their remuneration.

However, such considerations are relevant to how the board's work is organised, not to concerns regarding the board's integrity and any potentially adverse effects of failures of this kind. They are therefore not well-founded motives for imposing statutory regulation, but should generally be better left to the discretion of individual boards – or possibly to code regulation based on the comply-or-explain principle. In fact, had modern corporate governance emerged in a Continental European governance context, it is hard to imagine that matters regarding the internal organisation of boards' work would have been made subject to mandatory regulation.

Ostensibly unmoved by such considerations – although still with explicit reference to the kind of conflict-of-interest issues just mentioned – in its 2005 Recommendation, the Commission recommended the establishment of Audit, Remuneration and Nomination committees in listed companies throughout the EU.

¹⁸⁾ Among the four major Nordic countries, Finland and Norway also opted for the same solution in their national codes, whereas Denmark followed the Commission recommendation.

It should be noted that, although this was formally a non-binding regulation, in practice it was widely understood as quite a strong requirement, not to say a covert threat of statutory legislation unless appropriately complied with. Consequently, over the subsequent decade, corporate governance codes of a more or less voluntary nature were introduced in all Member States, generally providing for listed companies to set up those three committees.

Audit committees

Little more than a year after the 2005 Recommendation, it was followed by the 2006 Statutory Audit Directive requiring “public interest entities” (PIEs) to have an audit committee comprised according to specific criteria and assigned to perform certain duties, though with the possibility of Member States to exempt SMEs. In the original proposal, no flexibility was granted to instead allow the relevant duties to be performed by the board as a whole, if it should see fit. However, in view of the Swedish circumstances just described, Sweden, (along with some other Member States), adamantly requested such a possibility, and in the final negotiation, a clause to the effect that Member States could exempt companies with a body performing equivalent functions to an audit committee from the obligation to set up such a committee.

Then, in the wake of alleged failures of the statutory audit of many companies during the financial crisis, the 2014 Statutory Audit Directive was adopted as part of the aforementioned “Audit Reform Package”, (cf. p. 10), substantially amending the 2006 directive and expanding the role of the audit committee of PIEs. For a number of reasons, the implementation of those directives caused considerable challenges to Swedish lawmakers.

First, the regulation as a whole must be deemed largely superfluous in the Swedish context. Already in the mid-1990s, it had been contemplated as part of the then on-going review of the Swedish Companies Act to oblige listed companies to have an audit committee. It was, however, considered unnecessary, both on the aforementioned grounds that Swedish boards

were devoid of the sort of inherent conflict of interest problems that were the primary rationale for audit committees in Anglo-American boards, and because the duties typically assigned to such committees were already included in the broadly defined responsibility of a Swedish board. Nevertheless, for reasons of efficiency, many major Swedish listed companies had at that time already established some sort of audit committee, and with the inclusion of a provision to this effect in the Swedish Code, the practice was expanded to almost all listed companies and given a more standardised form. Therefore, when the 2006 Directive came, most of its content was already in place among Swedish listed companies.

Second, the requirement of the directive that *at least one committee member shall have competence in accounting and/or auditing*, (Article 39, point 1), risks assigning a stronger accountability for the work of the committee to the person designated to fulfil this criterion, which inevitably entails a corresponding alleviation of the accountability of other members. It thus stands in sharp conflict with Swedish corporate law tradition, according to which all members of a board – or a sub-committee thereof – have a joint and several responsibility for the discharge of their duties. What this distortion of the distribution of responsibilities among committee members may mean practice remains to be seen, as no precedential case has yet been tried in court.¹⁹⁾

Third, especially with the expansion of its role brought about by the 2014 directive, the audit committee was turned into an almost separate governance body, more or less independent of the board and with its own duties and responsibilities. Such an arrangement may be warranted in other governance systems, and is in fact not prohibited in the EU framework. In the Swedish context, however, where a board committee can comprise only members of the board and only perform functions within its scope of duties, and where the board as a whole is always responsible for any action taken by a committee, it would amount to a fundamental contradiction in terms. Moreover, since in Sweden, as we have seen, it is

¹⁹⁾ It should be noted, however, that the mandatory inclusion of specialists on the board is again discussed in the area of sustainable corporate governance, where one of the questions from the Commission in its public consultation was whether there should be a mandatory requirement for a sustainability expert on the board of directors.

in principle voluntary for boards to have a specific audit committee or not, any provisions pertaining to the duties of the audit committee must in the Swedish context be understood as directed to the board, leaving to its discretion the determination of whether to carry out those tasks as a whole or to set up a committee as a preparatory subordinate body. Against this background, it becomes confusing when the text of Article 39 of the 2014 Directive is consistently directed towards the audit committee, whereas the board is mentioned only marginally.

Finally, a fourth issue potentially has even more disquieting implications: The statutory auditor is strictly defined in the Swedish system as the shareholders' tool for reviewing not only the accounts and financial reports of the company, but also certain aspects of the performance of the board and management, (primarily pertaining to compliance with the Articles of Association and other relevant rules and instructions including, as the case may be, instructions issued by the General Meeting (cf. p. 13), rather than to the management of the company's business as such).

Thus, the board is itself subject to review by the auditor in the Swedish system, which makes it critical that a healthy "arm's length distance" be at all times maintained between the auditor and the board, (including, of course, any subcommittee of it). It therefore strikes a strange note in Swedish ears when the board – as a whole or through its audit committee – is required not only to "review and monitor the independence of the statutory auditor..." but, even more remarkably, to "monitor the statutory audit of the annual and consolidated financial statements, in particular, its performance...".²⁰⁾ In other words, *the reviewed is required to review the reviewer*.

Notwithstanding such considerations, the Swedish lawmakers found it unavoidable to implement these points almost to the letter, which, thanks to generally sensible people on both sides of this line of demarcation,

in practice seldom causes much harm. Yet they contain a disquieting seed of uncertainty about the integrity of the auditor vis-à-vis the company, and it remains to be seen what this will mean in terms of clarity of the responsibilities of the two parties in any forthcoming legal showdown.

Nomination committees

This committee is mandatory for significant financial institutions, according to the EU Capital Requirements Directive IV (2013/36/EU), but only recommended for other types of company. Even so, in the Swedish context it is a strange concept, fundamentally inconsistent with Swedish governance culture, according to which no member of a governance body should have a decisive influence upon the selection of their successor. Therefore, the notion of assigning to a subcommittee of the board the task of nominating candidates for board positions, first introduced in Europe by the Cadbury Committee, has never taken hold in the Swedish business community.

Instead, already in the autumn of 1993. *Aktiespararna*, (the Swedish Shareholders' Association), an association of mainly retail shareholders, introduced the concept of an "election committee", appointed by and predominantly made up of shareholders, in its pioneering "Guidelines for better control for owners of publicly listed companies".²¹⁾ In the subsequent decade, most major Swedish institutional investors followed suit in their various "ownership policies".

Hence the ground was already prepared when the Code Group, commissioned to develop the first national Swedish Code, was faced with the dilemma of how to take account of the provision in the then forthcoming 2005 Recommendation for boards of listed companies to have a committee for the nomination of candidates for board positions without breaking with Swedish governance principles. The solution was to pick up the

²⁰⁾ Directive 2014/56/EU, Article II, point 32.6, items (c) and (d).

²¹⁾ The trigger for this development was a proposed merger between the car-makers Volvo and Renault, which was finally withdrawn in December 1992 after a long and heated debate with Aktiespararna as one of its main critics, and which led to the resignation of almost the entire board of Volvo. To address this situation, a group of major Swedish institutional investors joined forces and formed "Friends of Volvo", a loosely knit cooperation forum whose aim was to nominate a new board for Volvo. This intervention of a number of institutional investors in the governance of a major listed company is generally seen as the origin of modern corporate governance in Sweden and the embryo of the Swedish version of nomination committees. For a more comprehensive account of this pivotal course of events, see Skog, R.: *A remarkable decade: The awakening of Swedish institutional investors*. European Business Law Review 2005, p. 1017.

concept of Election Committee, define and formalise it in a coherent manner and provide for the shareholders of listed companies to establish such a committee with the task of preparing the board election at an upcoming General Meeting. Since then, this form of shareholder-appointed nomination committee has become general practice among listed companies as well as many other types of company in Sweden.

4.2.3 Remuneration

This third key topic of early corporate governance has been subject to extensive regulation efforts by the European Commission. It began with the 2004 Recommendation on remuneration of directors of listed companies; continued in the wake of the financial crisis with the 2009 Recommendation regarding the regime for the remuneration of directors of listed companies, (and a corresponding recommendation the same year directed specifically towards the financial services sector); and was completed – to date – through parts of the 2017 Shareholders’ Rights Directive II.

In the international corporate governance discourse, remuneration regulation has been largely aimed at empowering the shareholders of companies with highly dispersed ownership to “have a say” regarding the remuneration of directors. Again, we see a reflection of the Anglo-American governance model, where the board traditionally has more or less singlehandedly been able to determine its own remuneration.

The Swedish system is fundamentally different. The Swedish Companies Act requires the General Meeting to decide on all remuneration of board directors in detail – no delegation to the board regarding director remuneration is permitted. Nor is the board part of the preparation process – the proposal for board remuneration is dealt with by the shareholder-led nomination committee.

Also with regard to remuneration of the CEO and other executives, the shareholders are in full control of remuneration matters throughout the governance chain – provided they opt to make use of it. This is accomplished through the ease and swiftness with which

the shareholders can issue binding instructions to the board or CEO, or have the entire board removed if they are unhappy with the way it handles matters within its decision competence. This feature of Swedish corporate governance may be a contributory cause for the more modest board and executive remuneration levels generally seen in Sweden, (as in other Nordic countries), than in some other parts of the world.²²⁾ It also means that much of the EU regulation within this field, largely aimed at strengthening the shareholders’ grip on board and executive remuneration, has done little more in the Swedish context than batter at open doors. When it comes to remuneration of executives, the EU regulation also involves an unfortunate interference to the Swedish governance chain, where the power to determine executive remuneration provides a crucial tool for the board to secure the best possible management of the company.

It is also worth highlighting in this context the long tradition of transparency and the strong role of self-regulation that characterises the Swedish business community, not least regarding matters of remuneration. Thus, already in 1993, the then Association for Generally Accepted Principles in the Securities Market (Sw. *Näringslivets Börskommitté, NBK*), a long-standing body within the corporate sector’s self-regulation system, issued a recommendation involving for the time quite far-reaching transparency regarding the employment conditions of CEOs of listed companies.

These circumstances notwithstanding, when the European Commission published its 2004 Recommendation on remuneration of directors of listed companies, its provisions regarding remuneration committees, a General Meeting vote on a forward-looking remuneration policy, (thus introducing “say-on-pay” on an EU-wide scale), and increased transparency regarding directors’ remuneration were largely incorporated in the then upcoming Swedish Code. However, the important difference was that the Swedish provisions applied solely to the company management, (since the remuneration of non-executive directors is, as we have seen, always to be determined by the shareholders). And a year later, in 2006, the Swedish lawmakers introduced a man-

²²⁾ See Lekvall, ed (2014) op.cit., pp. 84-86.

datory and binding “say on pay” vote at the AGM, also applicable to executives directly subordinate to the CEO, and required detailed disclosure at individual level of all aspects of remuneration of board members, the CEO and, where relevant, the deputy CEO. Arguably, a cause for this remarkable leniency towards a non-binding EU recommendation, in spite of the already strong grip of Swedish shareholders on remuneration matters, may have been a fear that the Swedish equity market would otherwise not be considered up to international standards in terms of corporate governance.

The next major step in this course of events was the Commission’s 2009 Recommendation regarding the remuneration of directors of listed companies, issued in the wake of the financial crisis and involving further far-reaching provisions, with particular focus on variable pay and share-based incentive schemes. With the consent of the Swedish Government, this regulatory act was to be implemented by the Swedish Corporate Governance Board through a thorough review and expansion of Chapter 9 of its existing Code, dealing with executive remuneration. This turned out to be a particularly challenging task, as many of the provisions in the recommendation proved difficult – and in some cases impossible – to reconcile with prevailing Swedish legal and/or self-regulatory conditions. Below follows a brief review of some of those provisions.

Recommendation 3.2, stating in brief that the “(a)ward of variable components of remuneration should be subject to predetermined and measurable performance criteria /.../ and include non-financial criteria /.../ such as compliance with applicable rules and procedures”. In the Swedish context, the last phrase of this provision would not be seen as a performance criterion, but as a condition for the payment of any variable remuneration at all, not to say grounds for legal action to have remuneration already paid reclaimed. In Sweden, compliance with applicable rules and procedures is a prerequisite for a director or a CEO to be granted discharge from liability at the AGM and cannot be used as example of performance criteria. The phrase was therefore dropped in the corresponding Code provision.

Recommendation 3.4, requiring remuneration contracts to include a claw-back clause, permitting the company to reclaim variable components of remuneration “awarded on the basis of data which subsequently proved to be manifestly misstated”. This provision was difficult to reconcile with Swedish conditions for several reasons, one being the fact that all remuneration accrued in a year triggers individual taxation the same year, thus making it complicated to have such remuneration repaid, especially if it was not paid in cash. On the other hand, if the recipient of the remuneration is culpable for the misstatement of the data on which basis it is made, the provision is superfluous, since in such a case the company can sue the individual for the financial loss suffered. For these reasons, it was not deemed possible to introduce an unconditional provision according to the letter of the recommendation. Instead, the board was obliged to *consider* imposing a restriction of this kind of remuneration paid in cash, (a consideration probably never having led to the imposition of such restrictions in practice).

Recommendation 3.5, providing in its second paragraph that “[t]ermination payments should not be paid if the termination is due to inadequate performance”, e.g. in the case of the CEO of a company. However, in Sweden, a CEO is normally employed with an until-further-notice contract with the difference, with the difference to any other employee’s employment conditions being that a CEO may be dismissed with immediate effect at any time. It is therefore necessary to grant the individual at least some minimum degree of security, if not through a reasonable severance pay then by substantially raising the fixed salary, which would in most cases prove considerably more expensive to the company. Depriving the CEO of a reasonable degree of financial security would only result in weakened integrity vis-à-vis the Board, thus fostering overly prudent and risk-averse rather than entrepreneurial CEO behaviour, not least to the detriment of the company itself. In addition, the criterion “inadequate performance” was regarded as allowing an unacceptable degree of subjective judgement and sheer arbitrariness in practical application.

For these reasons, this part of Recommendation 3.5 was not implemented. (The first paragraph, however, involving a cap on severance pay of two years' fixed salary, was implemented with the further restriction that fixed salary during a period of notice is also to be included in the cap.)

Recommendation 6.1, encouraging institutional investors to attend General Meetings and make use of their votes regarding directors' remuneration. Since the Swedish Code is directed exclusively towards companies, no provision of this purport was included in the Code. However, provisions of similar purport are included in the *Ownership Policies* of most major Swedish institutional investors and in the Swedish Investment Fund Association's *Guidelines for fund management companies' shareholder engagement*.

Recommendation 9.2, obliging the Remuneration Committee to ensure that any consultants engaged to assist in the development of remuneration systems do not simultaneously advise the human resources department or the company management. This is a typical example of EU provisions issued with little regard for the conditions prevalent in smaller markets. In a country like Sweden, there is only a very limited number of consultants with the knowledge and experience required to provide the kind of advice needed by major listed companies. For many listed companies, it may therefore prove difficult – if not impossible – to find consultants of the required standard without any other relationship to the company. For this reason, the Swedish Code simply stipulates that if the board or its remuneration committee uses the services of an external consultant, it must ensure that there is no conflict of interest caused by any other assignments of this consultant for the company or its executive management.

All in all, these and some additional minor deviations from the letter of the Recommendation caused the Commission to conclude in a report on its application by the Member States that at least half of the recommendations

had not been implemented by Sweden²³), a conclusion that in view of the efforts described to cope with some of the most difficult provisions must be regarded as grossly misstated. Furthermore, it should be noted that many of the provisions of the Recommendation were either written *in casu* or directed towards specific types of remuneration programmes and therefore did not cover other types of incentive programme or remuneration used in the Swedish market, e.g. the allowance of convertibles.

4.3 More limited-scope cases of judicial inconsistency

In addition to the broad areas of regulation discussed so far, this section will highlight a few examples of more limited-scope EU regulation more or less at odds with Swedish governance rules and procedures.

4.3.1 The certification statement in annual reports

As previously mentioned, (p. 8), the 2004 Transparency Directive included a provision requiring the directors' signatures on the annual report to be preceded by a brief "certification statement" to the effect that, to the best of their knowledge, the financial statements and the management report were prepared according to applicable standards and convey a true and fair view of the company's financial position and performance. However, intrinsic to their position as a board member, a Swedish director bears an individual liability for damage inflicted upon the company or its shareholders by intent or negligence that extends beyond what is specified in the relevant directive provision, (Article 4, item 2c). Therefore, the inclusion of a statement of the kind prescribed by the directive would in fact serve to alleviate the liability of a Swedish director. Furthermore, the phrase *to the best of their knowledge* would risk further limiting the liability to damage caused by intent, thus excluding negligence as grounds for liability.

For these reasons, no provision regarding a certification statement was included in the Swedish Annual Reports Act when the Transparency Directive was transposed into Swedish law.

²³) Report [COM(2010) 285 final] on the application by Member States of the EU of the Commission Recommendation (2009/385/EC) on directors' remuneration, footnote 1.



4.3.2 Detailed specification of board duties

Not least when it comes to corporate governance-related matters, the Swedish Companies Act is framed at a relatively high level of principles. Thus, the duties of the board are only stated briefly and in overall terms, to the effect that it is responsible for organising the company and managing its affairs, regularly assessing its financial situation, and ensuring that its arrangements for accounting, fund management and finances are adequately controlled, without specifying in more detailed terms what these duties embrace in practice. The underlying belief is that by shunning more detailed elaborations of directors' duties, the risk of leaving loopholes is avoided – nothing mentioned means nothing forgotten.

The EU corporate governance regulation philosophy appears largely devoid of such considerations. The most conspicuous example of this to date is the 2014 Statutory Audit Directive, where the duties of the audit committee are specified in quite detailed and concrete terms, (Article 39, point 6). To see the implications of this in the Swedish context, it should be borne in mind that a Swedish board committee can only comprise board members and only deal with matters within the board's scope of responsibility. Thus, in the Swedish context, the detailed duties of the audit committee specified by the Audit Directive are automatically transposed into duties of the board as a whole, which, in turn, is in conspicuous breach of Swedish legislative tradition as just described.

This conundrum was the subject of substantial concern in connection with the transposition of this directive into Swedish law. Nonetheless, the lawmakers finally found it unavoidable to include the provisions of the directive almost to the letter. This, together with a number of later similar cases, threatens to increasingly dilute the Swedish Companies Act and instead turn it into an ungainly mixture of overall provisions at a high level of principles and elements of cookbook-like detailed instructions.

4.3.3 Break-down of traditional responsibility structure in boards

Swedish civil law recognises no “collective responsibility”. All legal responsibility is individually borne. For corporate boards, there is a long-standing principle that the directors are jointly and severally responsible for the board's decision-making and for upholding its control functions, and that each director may be sued for damage caused by collective decisions or control failures if the director is deemed negligent.

Nowadays, this collective responsibility of board directors is increasingly being challenged by demands for designated directors with special competences. The most conspicuous example of this is the requirement for at least one member of an audit committee to have competence in accounting and/or auditing, but also the formation of special-purpose board subcommittees will in practice compromise the strictly joint and several allocation of responsibilities among board members that is characteristic of the Swedish corporate governance model.

A related problem is the mounting financial risk exposure of board members due to more severe sanctions for alleged neglect of duties, until now most pronounced within the financial services sector, but increasingly affecting other types of business. This problem threatens to be further exacerbated by recent ideas about broadening the accountability of boards to apply to wider circles of stakeholders than the shareholders, most recently being floated within the framework of the Commission's upcoming intervention regarding “sustainable corporate governance”, (see section 4.4.3 below). It may reasonably be questioned how attractive it will be to sit on boards with legal accountability to a more or less disparate circle of stakeholders with often mutually conflicting interests under threats of devastating administrative sanctions in case of alleged failure to adequately discharge one's duties. At the very least it will be sure to come with significantly increased costs for companies.

4.4 Two cases of more administrative than judicial implication

In this section, two major EU interventions are outlined that pose little problem due to sheer legal inconsistency with prevailing circumstances, but all the more through increased bureaucracy and a greater administrative burden for the companies concerned, generally to little or no benefit in terms of better corporate governance. And, as pointed out in the introductory section of this report, such regulation is far from harmless: First, although often bearable on a case-by-case basis, by being repeatedly added to through an incessant stream of new regulation, over time it turns into a significant burden even for large companies. Second, and in the long run probably even more damaging, it tends to divert the time and focus of boards and managements away from matters of business strategy and performance towards administrative matters and sheer formalities.²⁴⁾ Both these trends risk contributing to a continued undermining of the competitiveness of European companies in relation to their overseas competitors.

4.4.1 The NFRD and its related implementing acts

The Non-Financial Reporting Directive (NFRD), amending the 2013 Accounting Directive mainly by obliging larger PIEs to report annually on their performance regarding certain CSR-related matters and diversity policy, was generally well received in the Swedish business community. Indeed, many of the roughly 100 companies that were to be targeted by the new rules had already started to include sustainability information in their annual reporting. Even so, it was widely held that it would be valuable to give this information a more standardised format across companies, business sectors and Member States.

The directive was therefore implemented in close resemblance to its letter and content with one important exception: Since it was considered pointless to impose new legislation that would codify what was already largely general practice among the companies concerned, the Swedish lawmakers used the option, given

by the directive, to broaden its application to a wider range of companies. Thus, the criterion regarding the minimum number of employees at companies to which the rules would apply was lowered from the directive's 500 to 250, thereby expanding the number of companies concerned to approximately 1600.

A few years after the directive, the Commission issued an Implementing Act in the form of *Guidelines on non-financial reporting (2017/c 215/01)* which, contrary to the directive itself, caused considerable concern in the Swedish business community. It had been preceded by a consultation process during which many Swedish and international respondents expressed their concern regarding the level of detail and prescriptiveness which, it was considered, would severely limit the degree of flexibility in application allowed by the directive and significantly increase the administrative burden for companies compared with the directive. It was also pointed out that, whereas the directive allowed for guidelines on *methodology* for reporting, the consultation seemed to imply an intention to also extend the factual content of the directive.

However, little regard was apparently taken of such considerations in the final guidelines, which are in part very detailed and prescriptive and even expand the substance matter of the directive. One example of this is point 1(a) under Article 19a, which calls for “a brief description of the undertaking’s business model”. In the guidelines, this is proposed to include descriptions of the business environment in which the company operates; its organisation and structure; the markets in which it operates; its objectives and strategies; and main trends and factors that may affect its future development. Apart from the concern of such reports from a purely trade secrecy point of view, one may easily conceive of lengthy narratives of little relevance for the understanding of the company’s sustainability performance – or, the other way around, of green-washing boilerplate accounts of the company’s business. Another example is the extensive promotion of the use of key performance indicators (KPIs), preferably in quantitative form, to describe the

²⁴⁾ In fact, this development has given rise to ideas of establishing another governance body beside the legal board, often referred to as an Advisory Board, with the remit to focus solely on matters of business strategy and performance, whereas the legal board attends to regulation compliance and other formalities. This would be an extremely unfortunate development for several reasons, the most important perhaps being the lack of legal accountability it would entail for those governing the business.

company's sustainability behaviour, a practice that certainly facilitates comparisons but tends to do so at the expense of more in-depth and relevant information about the individual company. One cannot avoid the impression that this uncritical promotion of KPIs is aimed more towards satisfying the needs of major institutional investors and their proxy advisers, often having to deal with hundreds – if not thousands – of stockholdings, than of company owners with more concentrated holdings, which is in fact the dominating ownership model among European listed companies.

Finally, a point on the requirement to disclose: a description of the diversity policy applied by the company, the objectives of that policy, how it has been implemented, and its results in the reporting period, (Directive 2014/95/EU, Article 1, point 2(a)). In the guidelines, this is further extended to include a specification of the diversity criteria applied and an explanation of the reasons for choosing them. However, as mentioned previously, (p. 17), in the Swedish system, the directors of the board of a listed company are nominated by a committee appointed by the shareholders and led by shareholder representatives, while the board as such has no role in the process. Hence the company – through its board or otherwise – cannot account for the policy applied by the nomination committee or the considerations and objectives underlying this, unless the committee has opted to disclose this information, (which it has no obligation to do).

This provision is therefore not applicable in the Swedish system. However, the Swedish Code contains a provision to the effect that the board is to have an appropriate degree of diversity in terms of qualifications, experience and background with regard to the phase of development and other relevant circumstances of the company, and that an equal gender distribution is to be aimed for, (provision 4.1). In the transposition of the directive, this conundrum was solved by clarifying in a commentary to the law that if no diversity policy was disclosed by the General Meeting, the company could refer to this Code provision as the company's diversity policy.

Two years later, in June 2019, the Commission issued another Implementing Act to NFRD in the form of the *Supplement on reporting climate-related information* (C(2019) 4490 final), which further added significantly

to the extent and complexity of information requirements regarding sustainability matters. This document goes beyond anything previously seen in terms of level of detail, prescriptiveness and sheer textbook-type lecturing, and it undoubtedly in several aspects exceeds the factual content of the underlying directive. In fact, it specifies no less than 40 items of disclosure that should or may be considered, most of them to be supplied in the form of free-text narratives. There are also six tables of detailed KPIs to be considered, half of them of the “should consider” category and the rest being “may consider”. Many of the proposed disclosures are also very far-reaching and demanding. Consider, for example, the third Type 1, (i.e. of the “should consider” category), disclosure on Business Model:

Describe the resilience of the company's business model and strategy, taking into consideration different climate-related scenarios over different time horizons, including at least a 2 degrees C or lower scenario and a greater than 2 degrees C scenario.

Overall, these guidelines reflect a fundamental and largely misconceived lack of trust in the will and ability of European companies to voluntarily disclose pertinent environmental consequences of their activities. They also reflect an ambition to achieve a degree of comparability across companies, industries and countries that appears more aimed at satisfying the needs of major institutional investors and proxy advisers than those of more focused and engaged, long-term company owners. From the point of view of this latter owner category, it is generally more important to obtain crucial information about the individual company's risks and opportunities than to be able to make detailed comparisons across companies, industries and/or jurisdictions.

In summary, although the Non-Financial Reporting Directive largely battered at already open doors among major listed companies in Sweden, it was generally well received as a relevant and reasonably balanced common standard for sustainability reporting. As we have seen, the Swedish lawmakers even opted for a considerable expansion of the number of companies to which it was to apply. However, this positive image was turned on its head with the introduction of the two implementing

acts outlined above, both of which were considered to go far beyond the levels of detail and prescriptiveness appropriate in EU-level regulation. Furthermore, they undoubtedly exceed the factual content of the underlying directive, hence providing material regulation that has not been scrutinised through the established democratic procedure of EU-level legislation. The fact that those guidelines are formally non-binding does not significantly alleviate this impropriety, since in reality they are highly authoritative for the companies concerned.

As a final note in this context, as advised in its European Green Deal, in mid-2020 the Commission initiated a major review of the Non-Financial Reporting Directive, motivated by alleged weaknesses of the current system in terms of insufficient comparability and reliability of reported information; conflicting interests between issuers and users regarding information contents; some companies not reporting any non-financial information; and inadequate accessibility of information reported. This work is still in progress, with a communication on the proposal for a new Corporate Sustainability Reporting Directive (CSRD), replacing the NFRD, released on 21 April this year.²⁵⁾

4.4.2 The Shareholder Rights Directive II

While, as we have seen, the first Shareholder Rights Directive of 2007 had limited implications in the Swedish context, (as more extensive individual shareholder rights were largely already in place), the second directive of 2017, (SRD II), was more consequential on a number of accounts. Most importantly, it substantially expanded the “say on pay” notion, (by this time widespread in various forms among the EU Member States), to include not only a right of the shareholders to vote on an *ex ante* policy regarding directors’ remuneration, but also on an extensive *ex post* report regarding the same matters:

- The *remuneration policy* was to be submitted for a mandatory vote at the Annual General Meeting – binding or non-binding, at the discretion of the individual Member State – no less than every fourth year, but otherwise whenever made subject to material changes. The required content of the policy was spec-

ified in substantial detail and was to include not only the composition of the system in terms of different elements of remuneration and their relative weights, but also explanations of how the proposed remuneration contributes to the company’s business strategy and long-term interests and sustainability; a specification of all financial and non-financial criteria for the award of variable pay components, if any, and how they contribute to the same objectives; and, where applicable, the determination of vesting periods and conditions for the retention of shares after the vesting period of any share-based remuneration.

- The *remuneration report*, on the other hand, was to be submitted for an advisory vote – or, for companies falling below certain size criteria, a discussion under a specific agenda item – at the Annual General Meeting. The report was to provide a comprehensive overview of the remuneration awarded to the company’s directors during the past financial year, including detailed information on all elements of remuneration to each individual to which it applied.

As previously mentioned, Sweden had already had a law-based say-on-pay regulation for over ten years, involving a mandatory and binding Annual General Meeting vote on an *ex ante* remuneration policy.

However, Sweden had also had a *de facto* annual remuneration report within the framework of the Annual Report (of course also subject to a vote at the GM) for even longer, where all components of remuneration of not only the board members, but also the CEO and the deputy CEO were to be disclosed at an individual level. Against this backdrop, it was difficult for the Swedish business community to digest that it was necessary to add yet another comprehensive remuneration report to this already well-functioning framework, thereby causing further administrative work of little practical benefit to the market.²⁶⁾

Another disturbing consequence from a Swedish perspective was that the directive would further cement a long-lasting trend in modern corporate governance of transferring power over matters of remuneration

²⁵⁾ See https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_1806.

²⁶⁾ In fact, the notion of a mandatory GM vote on a remuneration report originally came about as a compromise solution in jurisdictions where it was not deemed feasible to require a mandatory vote on the remuneration policy.

from the board to the General Meeting. This may be justified in jurisdictions where board directors have traditionally more or less singlehandedly determined their own remuneration, e.g. in the Anglo-American system. In contrast to this, the Swedish system requires remuneration of non-executive directors, (who in listed companies make up the entire board, with the sole possible exception of the CEO), to be determined by the General Meeting, whereas remuneration of the executive management is determined by the board. Transferring parts of this latter decision competence to the General Meeting had two crucial adverse consequences: first, it reduce the directors' accountability regarding executive remuneration and transfer this instead to the General Meeting, where in practice, no shareholder can be held accountable for the decisions made; and second, this decision competence is moved from a body where each member is strictly obliged to look after the interests of the company as a whole and all its shareholders to a body where individual shareholders have no such obligation but may vote exclusively in their own interest. Unavoidably, over time this change has adversely affected the logical coherence and clear division of duties and responsibilities between the governance bodies that is a hallmark of Swedish corporate governance.

It should also be emphasised in this context that the power to decide on remuneration matters for the senior management and, at least in overall terms, for the organisation as a whole is one of the board's most effective tools for managing the company. Therefore, restricting this power risks severely weakening the board's capability to adequately fulfil its duty of care of the company.

Two subsequent Implementing Acts have been published in support of the practical application of this directive: in September 2018, the (non-legislative) *Commission implementing regulation (EU) 2018/1212*, dealing with the directive's provisions regarding shareholder identification, transmission of information between the company and its shareholders, and the exercise of shareholders' rights; and in July 2017, *Guidelines on the standardised presentation of the remuneration report under... [SRD II] ... as regards the encouragement of long-term shareholder engagement*.

Especially the latter, which as yet, (spring 2021), has only been published in draft form, has met with widespread criticism on several grounds, e.g. for

- being unnecessarily extensive, detailed and prescriptive, thereby causing excessive amounts of administrative work at limited value for investors;
- on several accounts going significantly beyond the substance matter of the directive;
- consistently prioritizing quantitative and often oversimplified comparisons across companies, business sectors and countries over information value in the individual case.

In fact, the in-detail prescribed format of the report, including in several cases set tables for various pay data, gives the impression of being designed more to enable, for example, remuneration consultants to establish and compare salary levels across the EU than to provide meaningful information to the market and the general public. An obvious side-effect of the excessive transparency of detailed pay data will also be upward pressure on salary levels, since no executives will want to feel underpaid in relation to peers in other companies. Arguably, the risk of such effects differs significantly between European jurisdictions, which is another argument against detailed standardisation of remuneration reporting.

A further peculiarity of the proposed guidelines is that they seem to introduce a comply-or-explain mechanism into a non-binding set of recommendations, a move apparently entailing a sort of contradiction in terms: if compliance with a provision is voluntary, why should companies be required to explain non-compliance? Regrettably, this provision serves to further underpin an impression of the guidelines as in reality being seen as more binding than officially stated.

To conclude, especially if the draft guidelines are adopted in anything like their current form, the SRD II will be yet another case of EU regulation imposing further increased bureaucracy and administrative work on companies while adding little value to Swedish corporate governance, but leading instead to additional remuneration costs.

4.5 A current issue

Naturally, this white paper has a predominantly rear-view perspective on the Commission's regulatory activities. Yet it appears unavoidable to also comment briefly on the on-going debate about the role of the business sector in the achievement of various societal goals, even though it remains to be seen what this may entail in terms of new regulation.

The background to this is a mounting criticism of companies for not taking adverse effects of their activities on the surrounding society sufficiently into account in the conduct of their business. In the general discourse, this view has been manifested under mantras such as “corporate sustainability”, “stakeholder inclusivity” and “the purposeful corporation”. The underlying premise is a questioning of the primacy of ownership interests as the basis for the governance of companies, instead calling for a broadening of the notion of corporate purpose to include a wider range of stakeholder interests.

Building on such thoughts, in Action 10 of its 2018 Action Plan on Sustainable Finance the Commission pledged to assess “the possible need to clarify the rules according to which directors are expected to act in the company's long-term interest”, and to commission a number of studies and consultations in order to further elaborate on this issue. To this end, in July 2020 the Commission published a major study, carried out on the Commission's behalf by the audit firm EY²⁷⁾, together with an Inception Impact Assessment²⁸⁾ of a contemplated initiative that aimed to realise most of the regulatory measures proposed by the study. Interested parties were invited to submit their feedback on these plans on the Commission's website.

The initiative met with heavy criticism from a wide circle of commentators on grounds of both severe methodological and theoretical deficiencies of the study and deep concerns about the outlined changes to fundamental corporate law principles in order to address the alleged problems. Nevertheless, only weeks after the expiry of this feedback period, the Commission

launched a new consultation on the same ideas, which ended on February 8 2021, and announced that it would be followed by a proposed regulatory initiative in the second quarter of this year.

These plans have caused deep concern among the Swedish business community and in academic and political circles. The criticism can be summarised in three key points:

- The *first* is the grossly inadequate evidence-basis of the proposed actions. As mentioned, the study on which the proposals are mainly founded has been severely criticised and flatly dismissed as unfit for purpose as empirical evidence underlying EU-level regulation by a broad range of distinguished commentators from Europe and the US. It must therefore sincerely be called into question whether it would be legitimate with regard to the European Treaty to proceed with legislative action so poorly underpinned by objective evidence.

Furthermore, it would also apparently be in breach of the subsidiarity and proportionality principles of the Treaty:

- the *subsidiarity principle* because matters of this nature can generally be dealt with more effectively and with higher levels of ambition by the Member States, where measures may be more closely adapted to national circumstances, than what is feasible with blunt EU regulation that can only be defined at a “lowest common denominator” level;
- the *proportionality principle* because the potential damage caused by the intended measures would be vastly out of proportion to the limited benefits of any EU-level legislation.
- The *second* is the proposed tampering with the fundamentals of European corporate legislation, the implications of which would be far-reaching and largely unforeseeable for the governance of companies and for the efficiency of the market economy. Apart from being in obvious breach of the Right to Property according to the EU Charter, requiring the board, as

²⁷⁾ *Study on directors' duties and sustainable corporate governance*. Report prepared by EY for the European Commission DG Justice and Consumers, July 2020: <https://op.europa.eu/en/publication-detail/-/publication/97cac494-d20c-11ea-adf7-01aa75ed71a1/language-en>

²⁸⁾ *Inception Impact Assessment – Ares(2020)4034032*: <https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance>

proposed, to determine the company's purpose on the basis of a balancing of the interests of the shareholders and an undefined range of other relevant stakeholders would involve a drastic transfer of power from the owners to the board, in reality stripping them of the control of their company. There is also the question of the extent to which private investors would find it attractive to supply risk capital to companies under such circumstances.

Furthermore, such a move would need at least the majority of the board to be appointed by – and represent the interests of – a broader range of parties than the shareholders, otherwise they could easily take back control by electing directors compliant to their interests. The key issue is who those other parties might be. In the debate, ideas have been floated about allocating rights of board representation to various relevant stakeholder groups, (a right already conferred upon the employees in Sweden and some other European jurisdictions, but never amounting to a board majority), or, even more far-reaching, the state. In either case, it would lead to the board comprising directors representing a range of divergent, and often no doubt mutually contradictory, interests – a sure recipe for board paralysis: diverging opinions regarding the means to obtain commonly held goals is standard and healthy in board work, but diverging goals among the directors, based on different underlying interests, would be devastating for the board's decision-making efficiency.

It should also be noted that directors under such circumstances would no longer be primarily accountable to the shareholders for the discharge of their duties, but to a wider circle of stakeholders, a situation that would in practice amount to accountability to none: a board held to account for unsatisfactory performance in terms of some stakeholder interests could always refer to having prioritised other interests.

In summary, transferring the right to define the company purpose from the owners to the board,

requiring this purpose to incorporate a range of different stakeholder interests without any clear order of priority among them, and holding the directors legally accountable to this more or less wide range of stakeholders would imply no less than a tremendous concentration of power to largely insulated and entrenched boards who in practice accountable to nobody. This, in turn, would risk seriously hampering the supply of risk capital to private companies and turn them into risk-averse “entrepreneurial zombies” rather than innovative and dynamic business ventures.

- *Third*, even from a purely societal point of view, it appears democratically highly questionable to rely heavily on private business leaders rather than on democratically elected politicians to solve crucial societal issues. Unlike business leaders, politicians can be held to account for the discharge of their duties in general elections.

Against this background, certainly from a Swedish point of view but presumably also from a broader European standpoint, a more viable approach would be to support and further encourage the already ongoing evolution among companies to take sustainability aspects of their activities increasingly into account in their own long-term interest. In fact Swedish companies, like those of the Nordic countries in general, have been relatively early adopters of a broader view of their role in society compared with many of their opposite numbers in other parts of the world.²⁹⁾ The underlying philosophy is a view of the company as an integral part of the society in which it operates, thus compelled to adhere to prevailing norms and values in order to maintain – and preferably further strengthen – its “licence to operate” in the eyes of the surrounding society. Today, examples of companies pursuing bold new ideas are legion, sometimes partly based on societal support but in many cases entirely on their own account, with the aim of providing competitive advantages based on superior sustainability performance.

²⁹⁾ See e.g. Jamali, D., Safieddine, A.M. and Rabbath, M.: *Corporate Governance and Corporate Social Responsibility Synergies and Interrelationships*. In *Corporate Governance: An International Review*, Volume 16, Issue 5, September 2008, 443-459, and Strand, R., Freeman, R.E. and Hockerts, K.J.: *Corporate Social Responsibility and Sustainability in Scandinavia: An Overview*. *J. of Business Ethics* 127:1, 2015, 1-15.

In such a context, mandatory legislation may in fact be counterproductive by setting standards of performance at lower levels than those that many companies would otherwise strive for, and by dead-locking this situation for a long time ahead. A better approach – at both the EU and national levels – would be to encourage voluntary change in behaviour through various types of opinion-influencing and attitude-changing activities, possibly reinforced by non-binding code regulation based on the comply-or-explain mechanism whenever deemed necessary.

And where self-interest incentives do not bring about the necessary behaviour, society must not hesitate to use its judicial toolbox in the form of legal restrictions, taxation, creating artificial incentive mechanisms such as the EU Emissions Trading System etc. to ensure that essential societal objectives are fulfilled. ◀

5. Outline of a better EU regulatory approach

On the basis of the above review of the Commission's regulation agenda to date and its impact on Swedish corporate governance, we will now look ahead and propose some changes aimed at improving its consistency with prevailing conditions in Sweden and possibly other Member States. The proposed measures fall into five main categories as follows.

5.1 Reduced overall amount of regulation

As should be evident from the preceding discussion, the sheer amount of EU regulation has posed considerable concern in the Swedish business community. Certainly, as we have seen, it has also involved many other types of challenge, some of which have posed serious threats to the Swedish governance model. Yet it has often proved possible to implement it in ways that have reasonably mitigated their potential damage. The vast quantity of new rules, however, further exacerbated by the highly detailed and prescriptive approach generally pursued, has not given the same scope to alleviate the negative consequences to the same extent. The result has been a huge increase in the administrative burden of companies and – as previously pointed out, probably even graver – in the time and attention devoted by boards to formalities at the expense of business considerations.

This development stands in stark contrast to the simplification mantra long pursued by the Commission. As early as 2004, the then incoming Commissioner McCreevy launched the slogan “better regulation”, signalling an ambition to substitute quantity for quality in EU regulation within his field of responsibility. Also later, Commissions have often referred to simplification as an overall objective, and in 2013 a specific Directive, (2013/34/EU), was devoted to the simplification of financial reporting requirements for certain SME-type companies.

Notwithstanding such commitments, the dominant trend has been an ever-increasing amount and complexity of regulation, in recent years often further exacerbated through the use of implementing acts that further add to the quantity and detail of provisions. As we have seen, in several cases this instrument has even been

used to expand the substance of the underlying legal act. Turning this unfortunate trend into its opposite would mean a significant improvement of the EU regulatory approach.

5.2 Stricter observance of the subsidiarity and proportionality principles

As repeatedly emphasised, superfluous regulation is far from harmless, even though it may not cause material damage to the targeted practices. Regulation widely seen as meaningless or irrelevant will over time also undermine the respect for more materially pertinent regulation. It is therefore crucial for the efficiency of any regulatory regime that the provisions imposed are considered relevant and justified by those affected by them. To ensure this in the exercise of legislative powers in the EU, the principles of *subsidiarity* and *proportionality* are key elements of the Treaty of the European Union. Although lip service is routinely paid to these principles in the preambles of proposed EU legislation, too often there is little evidence presented to back up the assertions.

In corporate governance contexts, the *subsidiarity principle* may generally be interpreted to mean that matters should not be made subject to EU-level regulation unless they cannot effectively be handled at Member State – or individual company – level. Unfortunately, not least in this report, examples of this principle being poorly observed by the Commission are legion, at least when seen from a Swedish perspective. To improve its performance in this respect, the Commission would be well advised to define the changes it considers necessary at a more principles-based level, leaving it to Member States to design the national regulation needed to comply with these principles. (More on this point of view follows below).

And the *proportionality principle* may in the same context largely be seen as designed to ensure that regulatory action taken at EU level does not impose administrative and other burdens on the business sector out of proportion to the size and resources of the companies concerned. Although the Commission has expressed

increased understanding of these problems in recent years, much remains to be improved. For example, as the PIE category includes all companies listed on a regulated market, any regulation directed toward such undertakings will apply to many quite small companies in Sweden. Of the slightly more than 300 companies currently listed on a regulated market in Sweden, approximately 1/3 fall within the Small Cap category, encompassing companies with market caps from 150 down to just a few million euros. Even less onerous provisions directed towards SMEs in EU legal acts often appear out of proportion for this category of companies.

5.3 Better evidence-based regulation

Another aspect of restraint in the creation of new regulation is to ensure that any proposed intervention is likely to solve, or at least significantly alleviate, the alleged problem. Regulation always comes with a cost, in terms of both administrative work and restricted freedom of action for those affected by it, and on occasion a proposed remedy may cause more damage than the problem it is supposed to solve. Therefore, all EU-level regulation should be strictly evidence-based, both through a strict *ex ante* cost/benefit assessment, ensuring that the contemplated regulation is likely to create more value than costs, and a thorough *ex post* follow-up on the outcome to establish to what extent the intended results have been achieved and to learn lessons for the future.

Sadly, the Commission has too often faltered on both those accounts. Granted, it has in the last decade or so increasingly called for external input at the initial analysis phase, e.g. by commissioning a study, summoning an advisory group of experts and/or launching a public consultation. The problem is that all too often such activities have tended to be strongly biased towards producing a preconceived outcome. A case in point is the study underlying the Commission's current initiative regarding *Directors' Duties and Sustainable Corporate Governance*, (p. 26). The stated objective of this study was to "assemble evidence of a possible trend towards short-term shareholder value maximisation on the

part of EU companies...". In view of this, it comes as no surprise that the report of the study met with devastating criticism, largely on grounds of inadequate objectivity and theoretical and methodological bias.³⁰⁾

Another issue of a similar nature is the composition of expert groups and task forces set up by the Commission to advise it on topical matters. Since the appointment process for such bodies generally involves a fair amount of self-selection, they tend to be dominated by people representing various organisations and groups with a specific interest in, and sometimes rather predetermined views on, the issues at hand. In stark contrast to this, owners, board members and executives representing companies subject to the contemplated regulation are often conspicuously absent. This further adds to the risk of biased outcomes of the *ex ante* assessment work.

Regrettably, the Commission's reporting on the outcome of public consultations often also leaves much to be desired. Typically, a simple "head count" approach is applied, through which numbers of respondents having delivered different answers are accounted for without any information on the background of these respondents that enables the reader to judge the relevance of their respective responses. This leaves much room for subjectivity on the part of the preparers of reports and makes it difficult for the reader to interpret and assess the results with any reasonable degree of objectivity.

To mitigate these problems, the Commission should take more care to design initial fact-finding efforts in truly objective and unbiased ways, e.g. by applying generally acknowledged research methodologies, showing greater transparency about the empirical data underlying reported findings, and ensuring that the targets of any intervention contemplated, mostly European listed companies, are adequately represented in professional forums set up to assist in the work.

Another key aspect of the *ex ante* evidence-seeking efforts regarding new regulation is to present a thorough Impact Assessment of the proposed action. The obligation to do so was introduced in the 1997 Treaty of Amsterdam, and ever since, the Commission has taken

³⁰⁾ See feedback submitted by e.g. Holger Spaman and a group of Harvard Law and Business professors, Alex Edmans, London School of Economics, the research institute ECGI and many other commentators on the Commission's website: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12548-Sustainable-corporate-governance/feedback?p_id=8270916,

great care to refer to such assessments when drafting legislative proposals. Unfortunately, however, all too often this has been done in an overly superficial manner, describing in overall terms how the assessment was carried out but providing little concrete detail that would allow the reader to review the work done and evaluate the conclusions presented. Again, the Commission should adopt a more science-based approach and disclose not only the results obtained and some overall references to the methodology used, but also a full professional report on the work done including, when applicable, the empirical data on which the results are based.

Finally on this matter, systematic *ex post* follow-up assessments of the actual outcome achieved through various regulatory interventions have until now generally been conspicuously absent. In fact, such activities on the part of the Commission have been largely confined to checking up on the transposition of EU legal acts to national regulation by the Member States. This may of course be well justified, but more fruitful with a view to expanding the knowledge basis for future regulation would be to systematically follow up the cost/benefit outcome “on the ground” of all EU regulatory interventions.

5.4 Greater consideration of prevailing governance frameworks in Europe

As we have seen earlier in this report, from its outset the corporate governance regulation agenda of the Commission has been largely focused on issues rooted in the Anglo-American governance system. This is even more remarkable as the EU market was at the time – and is so even more today following the accession of many eastern European countries and, most recently, Brexit – dominated by governance systems that differ fundamentally from this framework. Such differences apply not only to board structures, (i.e. one- vs. two-tier boards), but, more importantly, to such fundamental factors as ownership structure, shareholder powers and the division of duties between the governance bodies. Arguably, this approach has involved considerable challenges not only

for Swedish corporate governance but for that of several other European jurisdictions as well.³¹⁾

Admittedly, compared with the initial years of its regulation agenda, the Commission has over time paid increased attention to the multitude of corporate governance models within the EU, e.g. by incessantly declaring its strong dissociation from any kind of “one-size-fits-all” thinking. Nevertheless, all too often its regulatory measures have caused considerable friction when confronted with national governance frameworks, many of which are fundamentally divergent from the Anglo-American system.

Therefore, a change towards a more continental-European based paradigm must be considered long overdue. First, this should involve greater consideration of the multitude of governance frameworks that exist within the EU. Second, the Commission should start thinking more actively about specific governance issues characteristic of continental-European jurisdictions. To see what this might lead to, it is instructive to reflect on what the content of modern corporate governance might have been had it emerged out of European rather than US experiences. Doing so, it appears doubtful that governance issues like directors’ independence of the company, board committees and shareholder “say” on executive remuneration would have been singled out as key targets for regulation, as neither the supervisory boards of the two-tier system nor the Nordic unitary board involves the kinds of integrity problem that gave rise to such regulatory actions. Instead, questions regarding matters such as shareholder minority protection³²⁾, different forms of control-enhancing mechanisms, and the conduct of various types of control ownership, (families, foundations, the state etc.), might have been seen as viable areas for regulation. Exploring such a line of thought could offer the Commission a truly pivotal and constructive role in the further development of European corporate governance.

³¹⁾ See e.g. Hopt (2015), *op.cit.* p.

³²⁾ The Commission has started to show some interest in this issue of late, e.g. through the provisions regarding related-party transactions in SRD II and by commissioning TGS Baltic to carry out a Study on Minority Shareholder Protection, reported in January 2018. Still, much remains to be done in this respect.

5.5 More principles-based regulation

To a considerable extent, the difficulties encountered by the Commission in pursuit of its regulation agenda seem rooted in the very detailed, prescriptive approach generally applied. Inevitably, the more detailed and prescriptive EU-level provisions are, the greater the risk of conflicts with prevailing rules and practices at the national level. Examples of this are legion throughout the course of the Commission's regulation agenda, and they most likely apply not only to Sweden, as described in this report, but also to a greater or lesser extent to other Member States.

Therefore, a more viable way forward would arguably be to apply a more principles-based approach at EU level, while on the other hand requiring stricter compliance with the overall principles in their transposition into national regulation. After all, the fundamentals of corporate governance are very similar all across the western world, and certainly within the EU. It therefore seems reasonable to assume that it would be possible to obtain universal consensus among the EU Member States on a set of overall principles, together making up a common framework of good corporate governance. A model example of such a framework is provided by the G20/OECD Principles of Corporate Governance, although a corresponding European framework should probably be defined at a slightly more specific level, since the EU Member States make up a more homogenous set of jurisdictions than the membership cadre of the OECD.

The other side of such a strategy should be a more stringent follow-up on the implementation of the common principles in the Member States than has generally been pursued until now. Thus, no comply-or-explain option should apply, but the jointly agreed principles should be binding for the Member States, with an obligation to put them into effect through national regulation to the extent feasible with regard to prevailing legal and institutional preconditions. Of course, this might require more resources on the part of the Commission to oversee national realisation of the principles, possibly requiring the recruitment of company law and corporate governance expertise from each Member State. Still, this would

at least partly be out-weighed by the considerably fewer resources needed to create and develop the extensive and detailed EU-level legal provisions of today.

All in all, an EU regulation strategy along these lines could over time arguably lead to better and more harmonised European corporate governance landscape with less efficiency loss at national levels than the approach generally pursued to date. It certainly appears worth trying. 

6. Concluding remarks

As should be evident from this report, the EU regulation agenda within the field of corporate governance has involved considerable challenges and caused widespread frustration in the Swedish business community. In fact, most new corporate governance regulation in Sweden in the past two decades has been triggered by EU legislation.

So, how has the Swedish governance model fared under this pressure? Has it been severely weakened, e.g. by having had to digest too many alien elements or to accept too many diluting compromises, or has it generally prevailed in spite of significant strain? This question may be seen in conjunction with similar fear widely felt in the 1990s, but then due to influence from the rapid influx of international institutional investors into the Swedish capital market rather than to any EU regulation agenda.³³⁾

Remarkably, the answer regarding both periods seems to be largely affirmative: despite having incorporated a fair amount of more or less alien elements, on the whole Swedish corporate governance has managed to retain the core characteristics that have long served Swedish companies well. This has been achieved through a combination of steadfastness in defending its core values, creativity when it comes to finding suitable solutions to intriguing problems, and on occasion a touch of “disobedience”. In fact, taking a holistic view on this issue, the main long-term harm inflicted on Swedish corporate governance by excessive EU regulation is probably the adverse consequences of the sheer amount of regulation imposed rather than of a number of judicial inconsistencies *per se*.

It is also interesting to reflect on the extent to which difficulties to reconcile EU interventions with national preconditions discussed in this paper have occurred in other Member States. As pointed out from the outset, this report is strictly confined to Swedish circumstances, with just a few minor references to other EU jurisdictions. Still, it is reasonable to assume that many of those have also had their share of complications when it comes

to implementing EU regulatory interventions. This is likely particularly true for our Nordic neighbours, the corporate governance systems of which, as we have seen, very closely resemble that of Sweden. But there is reason to believe that several other EU jurisdictions, e.g. those involving two-tier board structures, the Italian so-called Latin model or countries with extensive state ownership of listed companies, may also have found it challenging to implement the largely Anglo-American-inspired regulatory actions pursued by the EU. Should the Commission consider it worthwhile to obtain a clearer view of these circumstances as a basis for its continued regulation agenda, a pan-European study to this end might provide some highly pertinent answers.

Finally, it is also interesting to reflect on the conceivable consequences of two decades of intensive EU corporate governance regulation for the global competitiveness of European listed companies. Although the opposite intent is incessantly maintained in the Commission’s impact assessments of its regulatory interventions, there are strong indications that the competitiveness of European companies versus their overseas competitors is successively being undermined.

There may certainly be a variety of factors underlying this development. Yet it does not seem unreasonable to assume that a fair share may have to do with the vastly increased bureaucratic burden – in combination with a continually reduced freedom of action to conduct their business – increasingly imposed upon European listed companies over the course of many years. In fact, this too would warrant a thorough empirical inquiry. ◀

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³³⁾ See e.g. Henrekson, M. And Jakobsson, U.: *The Swedish Corporate Control Model: Convergence, Persistence or Decline?* IFN Working Paper No. 857. Institutet för Näringslivsforskning, Stockholm 2005.

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