SWEDISH
CORPORATE
GOVERNANCE BOARD

COMMENTS REGARDING CORPORATE GOVERNANCE ISSUES IN THE EUROPEAN COMMISSION PROPOSALS ON MIFID II

The Swedish Corporate Governance Board, ("the Board"), has been invited to comment on the proposals from the European Commission, ("the Commission"), regarding revised regulations for on financial instruments, MiFID II. The new regulatory package contains proposals for a new directive, (COM(2011) 656) on markets for financial instruments, ("the Proposed Directive"), and a new regulation, (COM(2011) 652) on markets for financial instruments, ("the Proposed Regulation").
The Board has limited its comments to issues concerning corporate governance. These are dealt with in Articles 9 and 48, and to a certain extent in Article 65 of the Proposed Directive. As the content of Articles 9 and 48 is identical apart from the types of company covered by the rule, the comments in this position paper refer only to the rules contained in Article 9 of the Proposed Directive.
On 17 August 2011, the Board submitted similar comments to the Ministry of Finance on the subject of the proposals for CRD IV , which contains similar rules for banks and financial institutions to those in the current proposals.

1 GENERAL COMMENTS

In its responses to various EU initiatives concerning corporate governance in the past year, the Board has highlighted a number of points.

1.1 A substantiated need

New or expanded corporate governance rules should be based on a substantiated need for such regulation, just as is the case with any other regulation. In particular, there should be evidence that the rules will, or are at least likely to, lead to the desired outcome. In the case of the proposed corporate governance rules in the Proposed Directive, the Commission has not presented any convincing evidence for this. Point 5 of the preamble to the Proposed Directive states that there is agreement among regulatory bodies at international level that weaknesses in
corporate governance in a number of financial institutions, (which here ought to include securities houses), including the absence of effective checks and balances within them, may have been a contributory factor to the financial crisis. The Board questions whether it was weaknesses in the checks and balances between shareholders, boards and management teams in the individual institutions that propelled the financial crisis.

There is great risk involved in proposing detailed, mandatory regulation if there is any uncertainty regarding whether the rules are effective, meaningless or even potentially counterproductive. Furthermore, all regulation brings with it increased costs and, in the case of the rules now being proposed, the risk of reduced competitiveness for European securities houses, stock exchanges etc. The proposed regulation should therefore be subjected to a thorough cost-benefit analysis.

1.2 Rules based on principles rather than detailed regulation

Another point highlighted by the Board is that corporate governance rules are for the most part an extension of national legislation on companies. This also applies to corporate governance rules for securities houses, stock exchanges etc. The corporate governance models of different EU member states vary considerably. Despite the assiduous attempts of the Commission in the 1970s and 1980s, the EU has not been able to agree upon a common corporate governance model. In simple terms, there can

be said to be three different models, but closer analysis reveals significant differences between all member states.
The rules governing board composition, the work of the board etc that are covered by the Proposed Directive are an extension of the corporate governance rules to be found in each countries' national legislation on companies. That means that common detailed regulation at EU level is difficult to apply in practice in a satisfactory manner in every legal system. The rules proposed by the Commission should therefore not be detailed, but restrict themselves to principles. The underlying aim of each rule should be explained, while its precise structure and wording in order to achieve these aims should be flexible enough to allow it to be adapted to the circumstances of each country.

1.3 Use comply or explain in corporate governance

For corporate governance rules, the comply or explain principle is preferable to mandatory regulation, as it allows companies to try other, possibly more successful corporate governance models than those proposed by the regulator, providing they provide information about any deviation from the rules. The principle also makes it possible to write far-reaching rules, as companies are able to choose not to apply them. Mandatory regulation should only be used where it is deemed necessary and if it is known to produce the desired effects. To a great extent, corporate governance rules take the form of instructions or advice on how to improve the work of boards, as there are many different ways in which boards can work successfully.

1.4 Respect proprietary rights

Finally, it should be remembered that far-reaching restrictions on the rights of owners are questionable in a market economy. Furthermore, they can result in the state having to take responsibility for failures. If the state, through the offices of its agencies, rather than the shareholders decide on the composition of the board, for example, it is not unreasonable to hold the state liable and for the state therefore to bear the cost if the board does not do its job properly.

2 COMMENTS ON THE PROPOSED DIRECTIVE

2.1 Time for / number of assignments

Article 9.1 (a) of the Proposed Directive suggests a number of restrictions concerning the number of assignments a board member or executive may hold.

The Board does not believe that it is possible to have a detailed rule limiting the number of assignments an executive or a board director is permitted to have. While it is of course important that board members devote sufficient time to the assignment, introducing a rule concerning the number of other board or management positions a person is permitted to have is both unnecessary and administratively difficult. Furthermore, non-board assignments and commitments are not included in the proposed list – people may have commitments elsewhere, hold other positions or jobs, have families or pursue leisure activities that take up a lot of their time. The same applies to other roles within the same group of companies which may require a great deal of work. The question of how much time a person needs to devote to a particular task is also highly individual – some people may be able to do an excellent job in just a few hours per week while other members of the same board may need to spend much more time. That is the main reason why the Swedish Corporate Governance Code, ("the Code"), only requires members of boards to devote sufficient time to their assignment, without specifying any limitations of the kind suggested in the Proposed Directive.
The Proposed Directive states that the Swedish Financial Supervisory Authority may grant permission to individual board members to have more than one board position. It is doubtful whether the Authority can in any meaningful way assess whether the criteria are fulfilled – the Proposed Directive states that the individual circumstances are to be considered by the relevant supervisory authority. Is the Authority to carry out its own analysis of each individual's circumstances? It is the task of the chair of the board to ensure that all the directors devote the necessary time to their board assignment, which should then be followed up in the board's evaluation of its work and performance. In the Swedish model, it is the nomination committee, if one has been appointed, or the owner that then decides whether a board member is to be nominated for re-election.

If the goal is to have board directors of securities houses, stock exchanges etc devote more time to their board assignment and thereby ensure that the institution does not expose itself to uncontrolled risks, the best model must be to specify clearly that risk management is one of the board's most important tasks, that each member of the board is accountable for this and to ensure that liability for damages can be decided in a court of law within a reasonable period of time in cases where risk management has failed. If there are gaps or shortcomings in any of these areas, it is those that need to be addressed.

2.2 Honesty, integrity and independence of mind

Article 9.1 (c) of the Proposed Directive states that each member of the board is to act with honesty, integrity and independence of mind in order to be able to challenge executive management decisions when required. This is designed to be a mandatory rule, for which the European Securities and Markets Authority (ESMA) is to propose technical standards to be issued by the Commission, according to Article 9.4 (c). Is the Financial Supervisory Authority to test this rule? If so, how is it to do so? Are sanctions to be imposed on institutions if a member of its board is not honest at heart? In the opinion of the Board, this type of rule does not belong in a mandatory set of regulations which contains sanction provisions.

2.3 Views on other proposed rules

Article 9.1 (c) of the Proposed Directive states that member states' authorities are to oblige financial institutions to devote the personnel and financial resources needed for the orientation and training of board directors. The Board supports this rule. Article 9.4 (d) states that ESMA is to propose technical standards for these resources, which will then be approved by the Commission. The Board feels that this rule is inappropriate. It is the responsibility of the company board, the chair of the board and the individual director to ensure that all members of the board receive sufficient orientation and training in order to be able to perform their tasks in the best way. This is an issue dependent on the individual and should be determined according to the director's previous experience, education and training, competence and purely individual characteristics such as intelligence. There can hardly be technical standards for this. Furthermore, such detailed regulation by the ESMA may lead to reduced accountability for directors. They could easily declare that they have completed the training specified by the ESMA and that it is therefore not their fault that wrong decisions were made by the board. In the Swedish Code, it is primarily the individual board member who is to demand the training etc that he or she needs in order to be able to fulfil the assignment.

2.4 Nomination committees

Article 9.2 of the Proposed Directive contains a requirement for firms to establish a nomination committee within the board. This is not applicable in member states whose national legislation does not stipulate that it is the duty of the board of a company to appoint its members. Under Swedish law, it is the owners of the company who nominate and appoint board members, and this is formalised for listed companies through Code rules on owner-led nomination committees. The Board therefore assumes that Sweden is one of the countries covered by this exception.

2.5 Diversity

The Board shares the opinion that greater diversity of gender, age, educational background, profession and geography on boards, as presented in Article 9.3 of the Proposed Directive, is positive in some aspects. A similar rule is to be found in the Swedish Code, but the Board is of the opinion that the primary criterion is always that the members of a company's board possess the right competence. Whether a board would generally make better decisions from a risk management perspective because it has a more diverse composition according to the criteria specified in the Proposed Directive is open to discussion. In view of the lack of clear empirical evidence, diversity requirements should not be mandatory.

Further, the Board believes that there must be very strong motives for society to dictate to which individuals owners should entrust to manage their property. In the longer term, such regulation may weaken shareholders' proprietary rights and by extension weaken owners' responsibility for their companies.

Instead, it should be stated clearly that it is the responsibility of the owners to ensure that the company has an effective and appropriately composed board. To the extent that shareholders in certain jurisdictions within the European Union do not enjoy sufficient power and influence over the composition of the board to be able to bear this responsibility, it is this issue that should be addressed. The Swedish system, in which nomination committees are appointed and led by the owners and have a clear mandate to nominate the most appropriately composed board for the company, could serve as an example in this respect.

The second sentence of Article 9.3 states that investment firms are to put in place a policy to promote diversity, a rule which must be regarded as entirely unnecessary and will only result in unnecessary administrative costs. It is more appropriate to list the diversity criteria in the first sentence of this Article and to omit the requirement of a specific policy. .

Article 9.4 (e) of the Proposed Directive bestows upon ESMA the task of drafting regulatory technical standards for all the new corporate governance rules that apply to company boards. The power to adopt these standards would then be delegated to the Commission. As the Swedish Corporate Governance Board states above, corporate governance rules should take the form of principles which can then be implemented in each legal jurisdiction's own corporate legislation system. Furthermore, only those corporate governance rules that are regarded as completely essential should be mandatory. Further detailed regulation on these issues by ESMA is a step in exactly the opposite direction.

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The Swedish Corporate Governance Board

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